

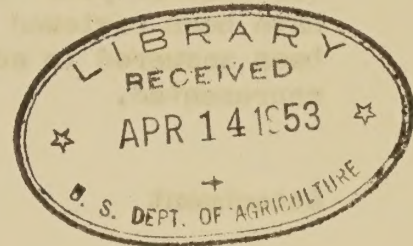
UNITED STATES DEPARTMENT OF AGRICULTURE  
Rural Electrification Administration  
Division of the Controller

November 14, 1952

To : Assistant Controllers  
Examination Managers  
Examination Supervisors  
Audit Analysts  
Field Examiners

From : Leslie Surginer, Controller  
Division of the Controller

Subject : June, 1952 Field Conferences -  
Summary of Divisional Activities



Transmitted herewith is a summary report of the divisional activities of the REA field conferences held at Old Point Comfort, Virginia and Denver, Colorado in June, 1952.

We believe that these conferences were among the most important ever held by REA, for the reason that they provided an opportunity for study, discussion and evaluation of changes in organization and procedures of the agency which became effective as of July 1, 1952. Of particular interest to members of the Division of the Controller were those phases of the conferences dealing primarily with changes affecting their day-to-day work.

Special attention is called to the summaries of talks presented by the Administrator, by representatives of the Office of Budget and Finance and the General Accounting Office, and by other outstanding speakers on internal control, internal audit and similar subjects related to our responsibilities. We urge you to take the time to read carefully all of the notes presented in this publication, as we feel that the principles, policies and procedures set forth herein are absolutely basic to a completely adequate performance of the duties delegated to this division in the new REA organization.

A summary of Administrator Wickard's talk to the field examiners has previously been distributed and it is also included in this publication in order that it will be readily available as a basis for interpretation of the responsibilities of field examiners. We feel that it will be especially helpful to you to read and re-read Mr. Wickard's talk since it presents fundamental philosophy with respect to the new duties which have been assigned to you.



Attention is also called to the field procedures set forth in the summary of the talk by the Assistant Controller - Examination relative to objectives, plans and procedures of the examination program.

The section at the end of this publication devoted to a summary of conference questions and answers should be very useful in the performance of your daily work. The questions presented at the conferences have been reviewed in the light of subsequent developments and have been answered in accordance with the current thinking on the problems represented.

Attachment

*Leslie Jurginer*

INDEX OF NOTES PREPARED IN CONNECTION WITH  
DIVISIONAL ACTIVITIES OF THE CONTROLLER'S DIVISION  
AT THE JUNE, 1952 FIELD CONFERENCES WHICH ARE REPRODUCED FOR STAFF USE

<u>ACTIVITIES</u>	<u>Page</u>
What the Administrator Expects of the Field Examiner (Administrator Wickard)	A
Activities of New Division of the Controller -- General Session (Leslie Surginer)	1
Staffing Pattern and Plans of the Controller's Division for 1953 -- Opening of Divisional Meetings (Leslie Surginer)	5
Internal Auditing (John C. Cooper, Jr. and Robert A. Stein)	7
Principles of Internal Control (E. T. Nolan and Harold J. Selinsky)	17
Appraisal of Internal Control - A Major Factor in Planning the Audit (T. A. Hoffman and Richard Platte)	23
Objectives, Plans and Procedures of the Examination Program (Robert A. Stein)	36
Services of the Technical Staff (Kenneth L. Smith and Keith H. Kittle)	41
Telephone Accounting and Auditing (Virgil P. Russell)	44
Panel Discussion of Questions From the Floor	49



REPORT ON THE ACTIVITIES OF THE DIVISION OF INVESTIGATION  
 AT THE BUREAU OF INVESTIGATION, DEPARTMENT OF JUSTICE  
 FOR THE YEAR 1935

Page	ACTIVITIES
4	What the Administration expects of the Field Division (Continued)
7	Activities of the Division of the Control — General Section (Continued)
2	Statistical Bureau and Plans of the Control Division (Continued) — Control of International Relations (Continued)
7	Internal Security (John C. Goss, Jr., and Robert A. Stein)
17	Examination of Internal Control (S. T. Nolan and Joseph J. Sullivan)
22	Examination of Internal Control — A Major Factor in Planning the War (T. E. Nelson and William H. Hays)
26	Collection, Plans and Progress of the Division (Robert A. Stein)
41	Services of the Technical Staff (Lamont L. Smith and John H. Kille)
44	Telephone Conferences and Meetings (Walter F. Brown)
49	Local Extension of Operations from the Field



TALK BY ADMINISTRATOR CLAUDE R. WICKARD

AT JUNE, 1952, FIELD CONFERENCES

ON

"WHAT THE ADMINISTRATOR EXPECTS OF THE FIELD EXAMINER"

Mr. Surginer, members of the Controller's Division, and guests, I am afraid there was an introduction made which cannot be fulfilled. I am afraid that you will not get from me everything that you should know, or what I expect of you, because I find myself in doubt sometimes about exactly what the new reorganization means to you as field people. First, apparently it means you are no longer auditors, but examiners. I don't know whether the significance of that has been explained or not, but I believe you can say that "examiner" will be a broader term and will involve broader responsibilities than just auditing of borrowers' books. On the other hand, I want to say that from your standpoint the over-all responsibilities are not too different. There may be more emphasis put on certain things but your relationships with the head of your division and with my office are not too different basically from what they have been in the past.

I find myself a little confused and perhaps I confuse you even more when I say that on one hand there has been a change and on the other hand there has not been a change. There has been a change in the broader scope of the work of your division, in that it has been given increased responsibility for examination. This broadening of your work from audit to examination is in step with the general change that is taking place in this field throughout the more progressive agencies of the Government.

As a matter of fact, there has been a change within the past few years in our relations with the General Accounting Office. As a result of the comprehensive audit program, there has been instituted a new relationship between REA and the General Accounting Office and between the Congress and the various branches of the Executive Branch of the Government through the General Accounting Office. I think that it has represented an improvement and will result in more efficient operation of the various branches of the Government, a better understanding on the part of the Congress as to what the Executive Branch of the Government is doing, and a better understanding on the part of the Executive Branch of the Government as to what the Congress wants done. The whole change, you might say, is toward a closer working relationship between the General Accounting Office as a representative of the Congress and the Executive Branch of the Government. It has meant a lot with respect to the change of responsibility in your division.

The General Accounting Office, having experience in dealing with many agencies of the Government, and through contact with Congressional Committees, is in a position to make suggestions. There may be some instances wherein there is disagreement among the Executive Branch of the Government, the Congress, and the General Accounting Office,



but such disagreement would seem to be eliminated, or kept to a minimum, if a common understanding can be gained of the responsibilities and objectives of each party concerned. This viewpoint has already resulted in an improvement as I see it. It means improvement from the standpoint of our own responsibilities and relationships with other branches of the Federal Government.

In this reorganization, as you have been told, your division has been given the internal audit job. Mr. Robert A. Stein and his internal audit staff has been transferred to your division. Mr. Stein, I am sure you realize, has done a very good job during the last few years in working with the GAO representatives and has been helpful to me and the entire program. It seems he can provide a better service, so far as our organization is concerned, by being in the Controller's Division where he can coordinate the program of internal audit and examination of REA and borrower operations with the program for audit of borrowers' financial transactions. Your responsibilities are not only a necessary part of the reorganization, but are the outgrowth of this new relationship between the General Accounting Office and REA. The reorganization itself is not giving you this responsibility.

You will no longer be auditing a number of the borrowers that you have been auditing in the past. You will be auditing the borrowers, insofar as operations are concerned, which have not made their debt service, generally speaking, for the last three years. That means you will be giving attention to those borrowers which have not reached for one reason or another this level of operating stability. For that reason we ought to be concentrating our attention and work with those borrowers, insofar as our funds will permit. Frequently, in the past, you were not making the kind of an audit that required an exhaustive check of a lot of things. The borrower was in a satisfactory condition and you made an examination of its financial condition and prepared a report. Now, you will be working almost exclusively in areas where greater attention is required.

Under the reorganization plan, there will be fewer official visits in the borrowers' offices than before. There will be less checking by the various parts of our organization, which calls, I think, for more and more attention on the part of the field examiners as to what has happened, because there won't be as many people to make reports. Another thing is that you people will be spending more time with the borrowers than anybody else. That will vary, of course, but you will be working with borrowers which require more assistance and you will be spending more time with a borrower on the average than you have been spending in the past because you will have more vexing problems to work with or more unusual conditions to face.

That gives you an opportunity to make some observations which no one else will have an opportunity to make. The very nature of your work gives you a certain responsibility. You will see weaknesses and certain things that are not satisfactory -- certain trends that will become apparent in your audit. Quite naturally you will be in a position not only to observe those trends, but to make observations as to the cause of the trends. I might say that it is not only the



trend toward the weaker condition or unsatisfactory position of the borrowers we would like to have you look into. If there has been an improvement, what has brought about that improvement? You will find out things that have caused improvements, as well as things that seem to have had a tendency to cause deterioration of the cooperative. In other words, in your every-day stay at a cooperative, make an examination of the various things you will have an opportunity to generally observe, such as the trends and what may be causing those trends on the plus or minus side.

I have given you what seems to me to be some of the reasons why you will be looked upon as field examiners, rather than as auditors, following the enlargement of the scope of your responsibility. I would like to turn the subject around and talk about it from the standpoint of the things you might question to avoid getting into trouble or to avoid cutting down on your own effectiveness or efficiency. These are words of advice and may be hard to take, but nevertheless it seems to me some of the things I want to say are the things which are good advice and are things to keep in mind.

If you are going to have this total responsibility, or wider scope, it means you people ought to be very well informed on general policies and procedures. It will be difficult for you to make a report on the progress or effect of the program, or any aspect of the program, if you don't have a general idea of the objectives and general policies. That is apparent. But on the other hand, don't think you will become an expert in every field. I would be a poor person to go out and criticize your auditing of any borrower's books. I don't know enough to intelligently criticize it. This matter of your becoming well informed must be limited to general policies and activities, as you surely don't want to try to criticize the sag of a line or some other engineering matter that somebody might bring to your attention. Not that you would ignore it, but you want an expert to go out and criticize the work of the technicians. You are a technician in your field and you wouldn't expect an engineer to come in and tell you about the fine points of your work any more than you would be expected to tell him of the fine points of his work.

I just want to add a word of caution. You must keep informed and have a general idea of the changes in policies and their relationships with borrowers and the program. Those are things that are important to you as you make observations <sup>of the progress</sup> of the program -- progress of REA in assisting borrowers and progress of the cooperatives in carrying out their responsibilities.

I used the word "observation" and I would like to say right there that my idea of a field examiner is that he is one who observes, during audits, the degree of compliance with and the effectiveness of plans, policies and procedures, as carried out by REA and borrower personnel, and that he is not a personnel investigator. You cannot say that a fellow goes into a cooperative office and observes exclusively and does not ask any questions and does not look into something that is put before him. However, if you get the idea, or



other people get the idea, that you are a snooper, or an agent of the Gestapo, your effectiveness will be destroyed. People are going to start covering up before you get there and your ability to get along with the employees of the cooperative will be impaired and there will be strained relations all around.

We don't want that to happen because we want you to maintain pleasant relations and keep on good terms with the borrowers and other people in REA. I want to emphasize that you must confine your activities and your reports in connection with this additional responsibility, by and large, to observations. I don't want to draw the line too hard and too fast because something may come to your attention and you may feel that before you write your report you need further information about it. You may feel you have to ask a question of someone. Make that question as unapparent, as to its purpose, as possible. Don't give the person in the cooperative office the idea that you have a new responsibility. Ask your questions casually so you don't create resistance or suspicion right off.

Let us talk about this matter of travel that has been giving us some concern. It may be reported to you, as you go about your work, that so and so from REA was there a couple of weeks ago and spent two days fishing or hunting. Maybe he did and maybe it was all right. Maybe he took annual leave, but the mere fact that it occurred may cause a question in your mind. You can see what trouble you get into if you ask questions of the cooperative people as to how long he had been doing that sort of thing, and who went with him, and whether he took leave. The fact that there was a little vacation activity might raise a question in your mind as to whether the fellow's travel report contained an explanation of time spent. If there was something to indicate that the activity in question had been going on for some time, you might ask a casual question of someone. That is the better thing to do than to go to the hunting lodge and ask when he arrived and if he shot anything. I am trying to point out that you should not make specific investigations, as I see it, without a specific assignment to do that sort of thing. I say that, not because we are trying to keep peace in the family, but because I am trying to point out what I think will make your work more effective.

The main thing is that you don't want to get the reputation of being detectives. You will find your work will be impaired and we don't want it that way. We want you to be in a position to give us good impressions -- impressions gained by you in your work that we want to know about. We would like to have the things you think are good and the things you can recommend, as well as the things you think should be changed or corrected. If you get the idea that all you are hunting for is some sort of fraud or irregularity or something similar, I think you will not be given the opportunity, and can't in your own mind, see the things we would like to have you see and report to us.



One other thing: Don't get involved in a lot of arguments -- arguments between other REA representatives and the officials of the cooperative. That is easy to do sometimes. It is in accord with human nature. Stay purposely out of those personal arguments that come up between other REA people visiting the office and officials of the borrower. Don't get into arguments among the manager and the bookkeeper and the board of directors. I don't think I need to tell you these things. They are things you would observe and would have watched, even though there were no change in your title or the responsibility of your division. They are good business procedures and make sense from the standpoint of administration.

The next thing I want to say is this: Don't report a lot of trivial things you observe around the office -- little personal actions of one kind or another, or a lot of gossip you hear. Those things are sometimes interesting, but we don't have the time to listen to or read all of them. Be factual and confine your reports to things that are important. That is going to make your work more effective and will help us. We don't have time to read about all of the things that happen. We are hunting for things that will make a contribution to the success, effectiveness and administration of the program and the work of our entire organization. Those are the things we want you to help us with in your observations.

The next thing I want to mention is to keep your own conduct above reproach or suspicion. You are not, of course, different from anybody else in that respect. I put it out to you as a word of caution because sometimes we fail to see, in our relationships with borrowers, that we can go only so far. You are naturally inclined to feel that you can be friendly with the bookkeeper or manager, but it does not mean you have to play cards with either one of them all night. It may be perfectly all right, but to the outside observer it may appear that the reason you did not show up until 11:00 the next morning was because you did not get to bed before 4:00 a.m. Sometimes these things are magnified. I know it is incumbent upon you who are out there to ascertain the facts, to be free in your own minds to ascertain these facts -- not in any way to be inhibited or restricted in your associations with the employees of the cooperative or anybody else. There again there is need for judgment. You cannot give everyone the stiff arm and be cold and indifferent and not sympathetic. Someone may come to you and talk about his problems and you will have to listen. You cannot give the idea you do not care. You probably will not learn much at all if you put a fence up around you. You would not want that, but on the other hand, you will have to be careful about your personal conduct so that no one can have any grounds for suspicion or criticism of your own actions.

Perhaps I have put more emphasis on the things you should not do than those you should do. I have put this emphasis on because I want to see you start off under this new title you have and your additional responsibilities rather cautiously. We are not ready



to write down everything you should do and not do in this new work. We are exploring with you the possibilities you have for helping us get more effective work and better relationships with our borrowers. You should go slowly rather than too fast because we do not want to create a lot of opposition for you and the REA.

This reorganization, in my estimation, requires more judgment, more tact, more ability, than what we had before and I want to say it was not reorganization that caused that but the changed status and the different relationships that grew out of the changed status. We are getting more mature and our borrowers are getting more mature. We should be changing our procedures in view of the maturity on both sides.

The things I have been talking to you about may seem somewhat on the kindergarten side, so far as my warning you is concerned, but as I said, we are trying to take advantage of this changed status. We do not want to say that the old order is out, that here is a complete revision of responsibilities and that we are coming in to do new and different things and leave the impression that you are the Administrator's bird dog looking after everything and everybody. That is the sort of thing that is not conducive to the effectiveness of our program.

Your chief concern should be with reference to your approach to your new responsibilities -- the attainment of that balance which avoids snooping and yet does not call for you to be blind.



## REA FIELD CONFERENCES

JUNE 1952

### SUMMARY OF TALK BY LESLIE SURGINER ON "ACTIVITIES OF NEW DIVISION OF THE CONTROLLER"

Internal Accounting Of the three basic groups in the division of the Controller, the Internal Accounting Group has the responsibility for the internal accounting functions of the Administration. Assistant Controller, Wells Ludlow, is in charge of this group.

Within the Internal Accounting Group, the Voucher and Employee Accounts Section audits administrative and loan disbursement vouchers, including your travel vouchers; maintains pay-roll, leave and retirement records, including responsibility for all pay checks; and maintains the cash disbursement registers for administrative and loan funds.

The Collections and Custodial Section receives and accounts for collections and deposits such funds in the Treasury; has custody of the loan documents; and distributes salary and travel checks and savings bonds.

The Loans Receivable Section maintains the loans receivable records; renders statements to borrowers and applies payments on loans receivable; prepares debt service, delinquency, and other reports on loans receivable; and, as requested, determines amortization factors and related data required in the preparation of loan documents.

The Statistical Services Section furnishes statistical advice and assistance to the Administration; collects and analyzes statistical and financial data on REA programs and prepares reports thereon; conduct statistical surveys; and provides tabulating equipment service for REA.

The General Accounts Section maintains the general ledger and other records, including those for control of obligations and expenditures; and prepares financial statements and reports.

Technical Staff The Technical Staff comprises that group within the Division which operates in a staff capacity to the entire organization with respect to accounting matters. The group is headed by Assistant Controller, Kenneth L. Smith, a CPA, who was active for nine years as a public accountant, spent eight years with the Federal Power Commission, has taught accounting at the Universities of Illinois and Denver, and has acted as a utilities consultant. There are also other CPA's on the staff.

The Technical Staff provides advice and assistance in the development, evaluation and improvement of electric, telephone and locker plant borrowers' accounting policies, systems and procedures; assists in the solution of special program and administrative problems involving accounting; and provides technical



advice and assistance in relation to internal accounting systems and examination procedures.

Examination The third group within the Division is that which has responsibility for examinations. It is under the direction of Assistant Controller, Robert Stein, who has been with REA since 1941, in the capacities of auditor, field supervisor, regional head, and internal auditor.

The Internal Examination Section, under the direction of the Internal Auditor, Eugene Riddle, has responsibility for the examination of administrative and program fund transactions and all related operations of the agency. This is carried out through ascertaining the degree of reliability of accounting and statistical data developed within the agency; appraising the effectiveness of operating procedures and internal records; determining that governing plans, policies, regulations, authorizations and procedures are adhered to and good business practices followed; and ascertaining the extent to which assets of the agency are properly accounted for and safeguarded.

### Field Examination Sections

General It is in connection with the examination function, formerly included in the Borrowers' Service Sections, that the principal changes have occurred. The responsibilities of the Borrowers' Service Sections with respect to the advance of funds and the rendering of accounting advice and assistance to borrowers have been transferred to the area offices and line divisions. Our responsibility will be primarily one of examination; however, we will render accounting advice and assistance to borrowers at the request of the area offices or line divisions. The internal examination functions at the field level will be performed ordinarily by the field examiners.

We have combined the Northeast and Southeast areas into the Eastern Section, and will have North Central, Western, and Southwestern sections which will correspond to the area offices. Each of the sections will be under the direction of an Examination Manager and there will be three supervising examiners, three to four telephone examiners, and 12 to 14 electrification examiners in each section. (The North Central Section will have only two supervising examiners.)

The Examination Managers will be: Al O'Donnell (Eastern); Rolland Mars (North Central); Howard Paine (Western); and Bernie Loving (Southwestern). The Examination Supervisors in the field will be: Peter Johnson, Jim Murphy and Jake Rubenstein (Eastern); Don Hase and Pete Schwan (North Central); Johnny Bear, Maurie Kay and Bill Lines (Western); and Harvey Buchanan, Merrill Riggen and Sid Hroch (Southwestern).

Functions The Examination Sections perform all staff activities with respect to the examination of the Administration activities in the field in connection with the examination of borrowers' records, and determine that agency objectives are being achieved in accordance with administrative policies and procedures through:

1. Examination of those borrowers' records and operations as determined to be made by the Administration.



2. Observation during such examination of any significant items affecting the Administration's relationship with borrowers.
3. Appraisal of borrowers' accounting systems and procedures to determine their effectiveness and recommend changes as necessary to provide for more complete and accurate reporting.

Under the reorganization plan, there will be fewer REA callers in the borrowers' offices than before. There will be less checking by the various parts of the REA organization; therefore, our examiners will pay more attention to what has happened because there won't be as many people as heretofore to make reports. The internal examination responsibility in the field will be carried on by the field examiner as a part of his regular examination. The role of our examiners will be that of observers and not investigators. It will be our responsibility to observe and factually report on compliance with established policies and procedures. This type of internal examination has as its primary objective the assistance of management in achieving the most efficient administration of the operations of the organization. This objective falls into major phases as follows:

- a. The protection of the interests of the agency, including the pointing out of existing deficiencies to provide a basis for appropriate corrective action. This involves the following:
  - (1) Ascertaining the degree of reliability of account/and financial data developed.
  - (2) Ascertaining that agency and borrower assets are properly accounted for and safeguarded from loss.
  - (3) Ascertaining the extent of adherence by agency and borrower representatives to established fiscal and operating policies, plans, and procedures.
- b. The furtherance of the interests of the agency, including the recommendation of changes for the improvement of the various phases of the operations. This involves the following:
  - (1) Reviewing and appraising fiscal and operating policies and plans in the light of related data and other evidence.
  - (2) Reviewing and appraising fiscal and operating records, controls and procedures in terms of their adequacy and effectiveness.
  - (3) Reviewing and appraising performance under fiscal and operating policies, plans and procedures.

It will not be our responsibility to attempt to evaluate the ability or performance of individuals. We want you to know that the personnel of this division must and will approach this new responsibility cautiously, judiciously, and with humility.



4. Special examinations and investigations as required.
5. As requested by line divisions and area offices, installation of accounting systems and rendering special accounting advice and assistance.
6. Technical administration of the program for the examination of borrowers' records by certified public accountants.
7. Review of all examination or audit reports prepared by REA examiners or certified public accountants for policy matters, clarity, technical performance, fairness of examination, and program objectives, including appraisal of practicability and appropriateness of recommendations made.
8. Furnishing information to line divisions and area offices with respect to adverse financial trends or other pertinent matters pertaining to borrowers' operations which may be developed through regular or special examination.
9. As requested by area offices and line divisions, discussion of examination reports with borrowers' boards of directors in unusual cases, such as those involving major violations of policies, defalcations, etc.

Methods of      With respect to rendering special accounting advice and assistance,  
Operation      the examination sections will operate in accordance with the general  
                  methods of operation indicated for all staff organizations, including the requirement that any contacts with borrowers be made only after specific authorization by the appropriate area director or line division chief.

With respect to the examination program, generally field examiners will not contact borrowers except at the request of, or in accordance with a schedule developed in collaboration with, line divisions and area offices; however, field examiners may be assigned in specific cases by the Controller to examine borrowers' records in connection with the internal audit needs of the Administration without clearance with the line divisions or area offices.



SUMMARY OF TALK BY LESLIE SURGINER ON "STAFFING PATTERN  
AND PLANS OF THE CONTROLLER'S DIVISION FOR 1953"

Reorganization of the  
Staff to Meet Changing  
Conditions

As you have probably learned by this time, the criteria for selecting borrowers to assume responsibility for their own audits has been revised to permit a great expansion of the CPA program. In making evaluations to determine whether the CPA program is applicable to a particular borrower, consideration is now given to the borrower's record with respect to such matters as: area coverage, member education and power use, maintenance, general managerial practices, and financial progress. Good financial progress, for this purpose, is considered to have been achieved if the borrower has earned at least standard debt service for the most recent three consecutive years or has indicated a trend in such earnings as to reasonably assure the earning of standard debt service in future years.

Over 350 borrowers are to be added to the number already responsible for their own audits, and there will be left for REA audit only about 360 electric borrowers. Most of these remaining borrowers subject to REA audit are in the central area of the country, which means that a considerable number of moves of field examiners will have to be made to meet the workload in those areas where the CPA program has less effect. You are to feel assured, however, that we foresee plenty of work for the staff in general and that there is little likelihood of a widespread reduction in force. It is expected that we shall have 26 grade 9 electrification examiners, 24 grade 11 electrification examiners, and 16 grade 11 telephone examiners. Field supervision is to be provided through a staff of eleven examination supervisors, with three being located in each section except the North Central, which will have two.

Planning the Field  
Examination Program

In line with the philosophy of the reorganization, which is based upon that stated in Administrative Bulletin No. 1, our division will provide examination service and accounting advice and assistance on a restricted basis and in accordance with the recommendations of area offices and line divisions.

As will be ~~strongly~~ emphasized in all of the succeeding talks during our divisional meeting, we have a new responsibility for review of borrowers' internal control and for observation of REA operations and reporting thereon. In undertaking this new responsibility, particularly that phase dealing with observation of REA operations, you are not only urged, but directed, to move forward slowly, be sure you are right in any comments you make on operations, and in general to be extremely cautious in performing your new function until some definite experience has been gained by the division which will permit the furnishing of more effective guidelines for your use. We must keep in mind at all times that we have been assigned this new function for the purpose of enabling us to provide the Administrator and the operating officials with information which will facilitate management control of the implementation of the agency's policies, plans, and procedures. This is right in line with the current trend in the government service toward increased accounting control and internal audit of administrative and program activities. In order to be of service to the



Administrator we must be careful to avoid any actions which will tend to lessen our effectiveness as unbiased observers. It is most fortunate that the Administrator has consented to appear on our program a little later and tell us in rather exact terms just what he would expect of us in our field examination work.



## INTERNAL AUDITING

- -

Talk Prepared and Delivered by John C. Cooper, Jr., Deputy Director, USDA, Office of Budget and Finance, at Old Point Comfort and Used as a Basis for Talk By Robert A. Stein at the Denver Conference.

- -

I appreciate very much this opportunity to discuss with you some aspects of internal auditing and their particular application to your work in REA. I am sure you appreciate the fact that this is a subject which we could discuss for many hours, particularly if we tried to tie down the application of internal audit principles to specific problems encountered in your day-to-day work. All we can hope to accomplish is a general discussion of internal auditing, touching briefly on certain highlights and elements which represent the real heart of this type of management control.

### Aspects of Internal Audit Activities in REA

In your agency you will be charged with audit activities which fall generally into two main categories, first, the audit of REA's internal operations and, second, the audit of the REA borrowers. Under some definitions, someone might try to differentiate between these types of audit by referring to them as internal and external audits. Frankly, I feel that too much emphasis has been placed on this difference and that in many instances some of the greatest values from the so-called external audits, in your case the audits of REA borrowers, are the evaluations of the agencies' operating procedures and relations with outside groups. For example, as a part of your new responsibilities you are specifically charged with reporting to the Administrator on the effectiveness of REA procedures affecting relations with REA borrowers. This is truly an internal audit function and I can think of no more effective means of really appraising the effectiveness and adequacy of these procedures than through the medium of your audit relationships with the cooperatives.

During our discussion, then, I will try to relate my comments primarily to the general activities included in an internal audit program with specific attention being given to certain elements which are essential to the success of such a program.

### What is Internal Auditing?

Today's concepts of internal auditing are quite different from those of a few years ago. Objectives and scope of duties have broadened materially and the standards of practice have been raised to a professional level.

In its early history, internal auditing was largely a clerical activity organized in many instances primarily as a policing function. The principal objectives were: (1) the detection and prevention of fraud and (2) the detection and prevention of errors. Too frequently the entire emphasis was on fraud detection.



One of the clearest statements on the purpose of internal auditing was recently set forth by the general auditor of the Standard Oil Company of California as "the over-all objective of internal auditing is to assist management in achieving the most efficient administration of the operations of the organization." The author of this statement is an individual who is entirely imbued with the management concept and approach for the internal auditor. We in the Department of Agriculture have the same concept as to the proper approach in our internal audit operations.

Another definition of internal audit is - "an internal audit is an analytical survey of various business activities, which in general uses as its base or entree, the various records--original or summarized-- of the company."

Recently a committee comprised of internal auditors of several of the agencies of the Department of Agriculture adopted the following concept of internal auditing:

"Internal auditing is an independent appraisal activity within an organization for the review of the accounting, fiscal, and other operations as a basis for protective and constructive service to management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of control. It deals primarily with accounting and fiscal matters but it also properly deals with matters of an operating nature because of interlocking relationships with the accounting system."

"It requires a proper study and evaluation of the existing system of internal control as a basis for reliance on the system and for the determination of the extent of the tests to which auditing procedures are to be applied. In evaluating the system of internal control, recognition should be given to work performed by other management groups."

"The objectives of internal auditing fall into two major phases as follows:

"A. The protection of the interests of the organization, including the pointing out of existing deficiencies to provide a basis for appropriate corrective action. This phase of the objective involves such activities as:

1. Ascertaining the degree of reliability of accounting and financial data developed within the organization.
2. Ascertaining the extent to which the organization's assets are properly accounted for and safeguarded from loss of all kinds.
3. Ascertaining the extent of adherence to established fiscal and operating policies, plans, and procedures. (In your REA audits, this would, of course, include an examination of the basic organizational and incorporation documents and authorities.)



"B. The furtherance of the interests of the organization, including the recommendation of changes for the improvement of the various phases of the operations. This phase of the objective involves such activities as:

1. Reviewing and appraising fiscal and operating policies and plans of the organization in the light of the related data and other evidence.
2. Reviewing and appraising the internal fiscal and operating records, controls, and procedures of the organization in terms of their adequacy and effectiveness.
3. Reviewing and appraising performance under fiscal and operating policies, plans, and procedures.

Internal auditing is generally considered as a staff or advisory function rather than a line or operating function. It does not involve the right to exercise direct authority over the other organizational units. Independence, however, is basic to the effectiveness of the internal auditing program. Internal auditing therefore, carries with it the freedom to review and appraise fiscal and operating policies, plans, and procedures. Such a review and appraisal does not in any way constitute approval nor does it relieve other persons in the organization of the primary responsibility assigned to them."

You can readily see that we in Agriculture have adopted a broad concept of internal auditing. I would like, however, to emphasize at this point that nowhere in our concept of the functions or duties of the internal auditor do we in any way disparage or lessen the significance and importance of the verification aspects that are so truly those of the auditor. Our emphasis is merely on the additional scope and coverage of the internal audit activities. For example, to tie this down to your every-day operation, our internal audit concept says that you will verify payments under the construction program but that in making such verification that you will also give due consideration to compliance with the provisions of the purchase contract and mortgage agreements, the use of materials procured under the contract, and any other similar items which may not be immediately involved in the verification of the expenditure under the contract.

#### History of Internal Audit in USDA

Before we get into a little more detailed discussion of internal audit activities, you might be interested for just a few minutes in the background of internal audit activities in this Department.

Some of the agencies in the Department have had examination or inspection activities for many, many years. The Farm Credit Administration, for example, which is one of the few agencies in the Department which has a specific provision in legislation for its examination activities, has effectively carried out such a program since 1916. The Forest Service is another agency which has very effectively used a type of internal audit which they designate as an inspection service.



In more recent years, there has been a concerted effort to establish and utilize this type of management control in agencies having large decentralized type of operations and where it has been determined that such an activity could be effectively utilized. The former Director of Finance, Mr. W. A. Junp, was a firm believer in the effectiveness of internal auditing and, as many of you know, he continually pressed for the utilization of every effective device which would result in increased integrity in the expenditure of Government funds and the most effective and economical use of such funds for the purposes for which they had been appropriated by the Congress. I am sure that some of you may have heard his often-quoted comment: "It is immoral not to be audited."

As a result of the sympathetic attitude of management in the Department and their earnest desire to continually effect improvements in operations, there has been a very close working relationship with the General Accounting Office both in the audit and accounting fields. Many years before even the enactment of the Government Corporation Control Act, the Department requested and received GAO audits of Commodity Credit Corporation operations. This same type of cooperation with the General Accounting Office has extended today through the introduction of the comprehensive audits. It was at the request of this Department that the GAO first initiated the on-site audit in RMA of the loan activities a number of years ago. Subsequent events have clearly shown the wisdom of this decision. I merely bring this out at this point so that you will know that we in the Department are today encouraging the effective use of internal audit programs and are striving for the very best results through a coordination of these programs with the audit responsibilities of the General Accounting Office.

The following statistics may be of interest to you:

28 percent of the bureaus of Agriculture are under comprehensive audit (6 of the 22 bureaus).

80 percent of the total funds appropriated by Congress are under comprehensive audit.

73 percent of the total full-time Agricultural employees are subject to the comprehensive audit.

This does not include approximately 20,000 members of the County Committee of FHA and PMA and the County employees of PMA. If these employees were included, the percentage of Agricultural employees whose activities or operations were being review<sup>ed</sup> by GAO would be higher.

#### Coordination with GAO Audit

I would like to take a few minutes to discuss some of the recent developments of internal auditing in Government. As you all know, until very recently all vouchers were sent to the General Accounting Office for a centralized desk audit. This system which had been followed for many years was generally recognized to be ineffective and outmoded. In recognition of the need for improved audit techniques, the Congress passed the Government Corporation Control Act in 1945 which provided that the GAO would conduct a modern, on-site commercial type of audit of the financial transactions of each of the Government corporations.



In addition to the deficiencies in the field of audit, it was also generally recognized that accounting and fiscal procedures in the Federal Government had become outmoded through failure to keep pace with the tremendous growth in the size and complexity of the Government. A coordinated plan of action to improve accounting was developed and agreed to in the fiscal year 1949 by the GAO, Treasury, and Budget Bureau. Some progress was made toward the improvement of accounting and fiscal procedures during the period from inception of this program to June 30, 1950. Legal and permanent status was given to the program by the Congress on September 12, 1950. (Public Law 784, 81st Congress, which is known as the Budget and Accounting Procedures Act of 1950.) This law set forth a declaration of policy which embraced the objectives which had previously been published as those of "Joint Accounting Program" and in section 113 placed specific responsibility for the establishment and maintenance of accounting systems and internal controls on the head of each of the executive agencies. That part of the Act which pertains specifically to internal audit reads as follows:

'Sec. 113 (a) The head of each executive agency shall establish and maintain systems of accounting and internal control designed to provide effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit.

'Senate Report 2031 in explaining section 113 states as follows:

'The intent and purpose of section 113 is to place upon the head of each executive agency for the first time the clear responsibility for the establishment and maintenance of an adequate and complete accounting system.'

The law and the reports thereon clearly point out that the system of internal control includes a comprehensive and independent internal audit of the agency's transactions.

In addition to the service which internal audit organizations render to their own agencies, the work of these groups, when properly conducted, is being accepted by the General Accounting Office, thus preventing duplication in the conduct of comprehensive audits of agencies and corporations. The Budget and Accounting Procedures Act of 1950 provides that the General Accounting Office will extend on-site or comprehensive type audits to the various executive agencies as rapidly as possible. A number of agencies in the Department including REA, in addition to the Government corporations, are receiving comprehensive audits of their financial transactions by the General Accounting Office. The General Accounting Office considers an independent internal audit staff to be an essential part of the system of internal control and has recommended establishment of such organizations in those cases where this type of service was not being rendered.

#### Utilization of REA Audit Reports by General Accounting Office Auditors

There is quite a long history behind the present system in REA of advancing funds and accountability for loan funds by REA cooperatives. During this period there have been numerous discussions with GAO with respect to the type of documents and also the type of accountability. Very early in these negotiations, the GAO accepted the premise that the most effective means of control was through the REA audit of the cooperatives.



More recently, this general theory has been accepted by the General Accounting Office in connection with their comprehensive audit of REA. I would like to emphasize, however, that your audits of the REA cooperatives as well as your audits of the internal operations of REA are a very important factor in the system of internal control which the Comptroller General expects REA to carry out.

I am sure that Mr. Hoffman of the GAO will cover this subject thoroughly in his discussion with you but I would like to emphasize that from the position of the Department, we hope that not only will the work of the internal auditors be sufficiently well planned and well executed that it will be readily acceptable to the GAO auditors, but that your work papers and reports will be carefully prepared and will adequately reflect the work which has been done.

#### Prerequisites to the Establishment of an Internal Audit Program

There are many factors which must be taken into consideration in establishing an internal audit program. Once established there are also a number of factors which will materially contribute to the success of such a program. One of these, and to me the most important, is to have an administrator of the organization who is sincerely interested in the utilization of this particular type of service and who fully recognizes the benefits to be derived from the effective operation of such a staff. This initial requirement, of course, has been met in REA and I can assure you that your Administrator is looking to you and depending on you to exercise every skill that is at your command to adequately report on the operations of REA. Another important consideration is that there must be a type of organizational structure or elements of program operation involving delegation of responsibility, separate operating units, etc., which justify the need for this type of management control.

#### Qualifications of an Internal Auditor

It might be well at this point before we get into a more detailed discussion of the duties and responsibilities of the internal auditor to consider for just a few minutes the qualifications of the auditor. In a recent textbook on auditing, the author gives almost two full pages of qualifications which he considers essential to the successful practice of public auditing. Admittedly, many of these attributes are a prime requisite to success in any profession.

For our purposes today, let's say that the internal auditor must have basic technical knowledge and training in the accounting and auditing field. In addition, the following attributes are essential:

1. He must be fair, tactful, cooperative, friendly.
2. He must possess initiative, ingenuity, responsibility, curiosity, resourcefulness, analytical ability, reasoning powers, and good judgment.
3. He must be able to recognize matters that are important as distinguished from unimportant.
4. He must be trusted to conduct himself properly while away from headquarters.

Two of these need a little emphasis in my opinion. The first of these is initiative and in some respects one of the most important. Technical qualifications and all of the other attributes are necessary qualifications. But there is one thing that you must be convinced of and that is that no one at any level of operation can tell you exactly what to audit, when to audit it, and how to audit it. Internal audit programs must be initially tailor-made to fit the operations and must be designed as a management tool. It is, of course, recognized that audit programs must be prepared, scope of operations must be considered and well directed, and suggestions may be made from time to time such as I am sure will be covered during the course of your meetings here, but none of these in any instance can take the place of the responsibility which is placed on each of you individually to exercise all of the initiative which he can muster to satisfactorily perform the job which the Administrator of REA and your Comptroller expect.

Another of the personal qualifications essential to the success of an auditor is that of judgment. It is, of course, difficult to draw a fine line between some of these personal attributes, but let me emphasize that the facility with which a job is accomplished, the thoughtful attention given to the materiality of items disclosed during an audit, and the application of judgment in the method and technique of reporting items which you consider warrant management's attention are all aspects of the exercise of the judgment factor on which the success of your audit program may depend.

Another, and a very important one is that the internal auditor must know the organization and operating procedures. This may seem to you to be a gratuitous suggestion but unless the internal auditor is fully familiar with the scope, purpose, policies, and procedures of his administration, it will be impossible for him to accurately report to management on the effectiveness of such matters as they affect the operations of the agency.

#### Duties of the Internal Auditor

Our present day concepts of internal auditing, as has been previously indicated, do not require the auditors to follow the traditional balance sheet program which is frequently used in the field of public accounting. I would certainly grant that in your work in REA one of your responsibilities will be to determine the financial condition of the REA cooperatives, but let me emphasize again the management aspects of the statement on internal auditing and particularly the following three important points:

1. It is a type of management control
2. It is an examination and appraisal activity
3. It may properly deal with operating as well as account/and financial matters.

I do not want to in any way de-emphasize the importance of the specific responsibilities which you have to cover completely a review of financial operations. This aspect of your work I have more or less taken for granted in my discussion.



Our point of emphasis is on the additional responsibilities which you must now assume under the broader and expanded scope of your charter in REA to review, appraise, and determine the effectiveness of systems of internal control and the necessity for observing and reporting on all types of procedures, records, reports and other control devices which may have been established in connection with either the operations of the local cooperative or the Administration.

### Objectives of Internal Audit Activities

While the general over-all objective of internal auditing is to assist management in achieving the most effective administration of the operations of an agency, its many subsidiary objectives can be classified under two general headings: (1) Those which are essentially protective, (2) those which are essentially constructive.

### Protective Objectives of Internal Auditing

The protective objectives comprehend not only the detection and prevention of fraud and errors, but the rendering of many other services designed to protect the interests of an agency.

The complexities of modern management and the necessity for decentralization of activities have forced administrators to delegate more and more of their normal operating and administrative responsibilities. Conditions of this kind create an increasing need for a staff to keep management informed concerning the carrying out of its directives and provide a natural situation for the effective utilization of an internal audit staff. In a way, the internal auditor supplies management with an extra pair of eyes; he surveys, observes, appraises, and draws to management's attention those matters which he feels should receive consideration.

The following are examples of the auditor's protective duties:

- (a) The auditor is charged with the responsibility of observing the application of REA's policies, and is required to report any variations not in the best interest of REA. Of course, some variations may be good.
- (b) It is also the duty of the auditor to review the recording and accounting treatment of fiscal transactions to note their conformance with established procedures.
- (c) The observance and appraisal of the effectiveness of operating plans, procedures and policies required by management for its information and guidance, is also a function of the auditor.
- (d) It is a prime responsibility of the internal auditor to observe the system of internal check to determine its adequacy and effectiveness.
- (e) The auditor is expected to detect waste, exposures, hazards, and other contingencies that might adversely affect REA's interests.

- (f) In addition, the auditor should review and evaluate accounting and statistical data to detect inaccuracies and fallacies that might go undetected and thus cause management to act upon unreliable information.

While these are only a few of the many items that come under the heading of protective service I believe they are sufficient to illustrate the true meaning of this term.

This protective service is not set up because of any lack of confidence in subordinate executives or the clerical workers who handle the details of transactions, but for the reason that experience has proved that exceptions, deviations, and imperfections do develop, even in the best regulated organizations.

### Constructive Objectives of Internal Auditing

The constructive objectives of the internal auditor are concerned with furthering the interest of the agency through seeking out possible ways of improvement of the various phases of the operations of the agency. These may involve (1) policies and plans, (2) internal records and the procedures which relate to the matters there recorded, and (3) the performance under existing plans, policies, and procedures. For example, in connection with your review of field application of REA's policies, you not only observe compliance therewith, which is a protective service, but also note their effectiveness. You may find that in actual practice they do not work out as management anticipated, either in whole or part. You may feel some modification or revision would be desirable. In such a case, you report your facts to management for its consideration. Your report will become a source of dependable and objective information, which management officials may use with confidence in planning and carrying out program activities.

### Internal Auditor is a Staff Official

It should be remembered that the auditor is not a "line" executive but a "Staff" man, and as such he does not give orders; he merely reports facts for a line executive to consider and to take such action as the circumstances may require. The auditor does not hold himself out as an expert in all phases of business management, and therefore many of the matters on which he comments are submitted for the attention and consideration of competent authority.

Because the auditor's responsibilities require him to review the functions of other employees, make appraisals thereof, determine imperfections and deficiencies and express opinions concerning matters which he feels need consideration, some employees are apt to get the false idea that he is trying to run the business. I feel that if the employees of an organization could better understand the auditor's duties and responsibilities, and the objectives of the internal audit functions, an improved relationship could be developed between the auditor and other personnel. A real internal auditor truly wants to be helpful and not a thorn in anyone's side.

The internal auditor must be honest, fair, impartial, unbiased, tolerant and considerate, yet fearless enough to report fairly to management the results of his examinations. But in doing so, he should be constructive and not merely critical.



### Independence of Internal Auditor

You will note that in the very beginning of the statement on internal auditing, the first important word is "independent." This recognizes that the internal auditor shall have the maximum independence possible within an organization. Independence also means complete detachment from line responsibilities. In REA, you have such independence.

### Internal Audit Reports

No discussion of internal audit activities would be complete without devoting a few minutes to the importance of internal audit reports. It has been my experience that while report writing is possibly one of the most important of the duties of the internal auditor, yet it is frequently the most neglected.

Admittedly, writing any kind of a report is a difficult job and certainly it is more difficult for some individuals than for others. When you add to this difficulty the necessity for taking facts and figures and interpreting them in such a way that they will serve management's needs and hold management's interest, it becomes a problem of considerable importance.

I am sure that I do not need to emphasize the fact that audit reports must be accurate, brief, and clear. Too much emphasis cannot be placed on the necessity for the presentation of facts on a completely objective basis. Experience has indicated that more difficulties and misunderstandings arise because of a failure to completely and objectively present all of the facts than almost any other one part of report writing. The report must be brief if it is to hold the attention of management.

A few years ago, the general auditor of the General Motors Corporation advised his auditors to always keep five things in mind when preparing reports: (1) correctness; (2) clarity; (3) conciseness; (4) courtesy; and (5) character. There is no question but what these five elements are equally essential prerequisites to effective report writing and management acceptance in your work in REA.

## PRINCIPLES OF INTERNAL CONTROL

Talk Presented by Harold J. Selinsky, Systems Accountant, General Accounting Office, at REA Field Conference, Denver, Colorado, June, 1952.

This talk is partially in duplication of an earlier talk on the same subject delivered by E. T. Nolan, Assistant Chief, Accounting Systems Division, General Accounting Office, at the REA conference at Old Point Comfort, Virginia. Incomplete notes make it impossible to include Mr. Nolan's exact discussion in this summary.

My assignment today is to talk about the principles of internal control. There is much to talk about in such a subject -- much more than I thought there was when I began preparing what I would say to you. Since then, I have been literally haunted by the subject of internal control. I no longer can enter any kind of business establishment without first casting my eye about for obvious internal control features. In most stores the thing that catches my eye is the cash register -- an internal control device that brings the buyer into the control scheme by telling him how much he is being charged for his purchase. At the same time it calls the attention of other employees or the manager to the fact that a register is being opened, and also adds up the total cash receipts for the day that the salesperson is accountable for, which amount is concealed from the salesperson.

In buying gasoline at a service station, I notice that the pumps measure the gas that is delivered into my tank and compute the total sales price. I also notice that the pump records total gasoline deliveries as well as total sales price of all deliveries. I use a credit card and notice that the station keeper writes up the transaction on a pre-numbered, multi-copy sales invoice which he asks me to sign.

In making a purchase at a department store I find that the sale is recorded on a pre-numbered, multi-copy, multi-purpose sales slip, which I sign. Before I can leave the store with my purchase, I find that I must go to a wrapping desk where I observe the wrapper comparing the sales slip with the articles wrapped.

These are ordinary transactions, yet each illustrates a common application of internal controls in our daily lives.

I am sure that internal controls existed ever since man's activities were expanded to the point where it became necessary to hire others to carry on some phase of the business, because controls in one form or another are inseparable from business activity.

There has always been recognition given to the fact that internal control goes far beyond accounting transactions and applies to all management activities. An early example of the breadth of internal control may be found in our own U. S. Constitution. The idea that the three branches of government would serve



as a control or check on each other was clearly advanced by those who supported the adoption of the constitution -- as well as by others ever since -- even as recently as a couple of weeks ago.

The breadth of internal control is well set out in a recent special report on Internal Control by the Committee on Auditing Procedures of the American Institute of Accountants, which stated:

"Internal Control comprises the plan of organization and all of the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies."

This definition recognizes the importance of the safeguards or internal checks which should be an integral part of the accounting system, and at the same time, it stresses that part of the controls which functions in the area outside of the accounting system.

In recent years there has been a steadily growing understanding by management as well as by the public accounting profession of the significance of developing sound internal controls. This understanding is attributed to the following factors in the Special Report on Internal Control, which I just mentioned:

- "1. The scope and size of the business entity has increased to the point where its structural organization has become complex and widespread. To control operations effectively, management must depend on the reliability of numerous reports and analyses.
- "2. The primary responsibility for safeguarding the assets of concerns and preventing and detecting errors and fraud rests on management. Maintenance of an adequate system of internal control is indispensable to a proper discharge of the responsibility.
- "3. The protection which a properly functioning system of internal control affords against human weaknesses is of paramount importance. The check and review which is inherent in a good system of internal control reduces the possibility that errors or fraudulent attempts will remain undetected for any prolonged period and enables management to place greater confidence in the reliability of data.
- "4. It is impracticable for public accountants to make detailed audits of most companies within economic fee limitations. Furthermore, a subsequent examination cannot be regarded as substitute for the exercise of proper controls in the actual handling of transactions."

The foregoing points are stated in terms which seem applicable to private business activity. However, the same factors, restated in terms applicable to the business of the federal government, are also responsible for increasing recognition of internal control there. In September, 1950, the Congress enacted the Budget and Accounting Procedures Act of 1950 in which repeated reference is made to internal control. In that Act, the policy of the Congress is declared to be (in part) that "the accounting of the Government provide full disclosure of the results of financial operations, adequate financial information needed in the management of operations and the formulation and execution of the Budget, and effective control over income, expenditures, funds, property and other assets."

This Act further provides that the responsibility for establishing and maintaining the systems of accounting and internal control designed to carry out the policy of Congress rests on the head of each executive agency.

In carrying out the responsibilities of the General Accounting Office under the Act (as well as others) full recognition is given to the agency systems of internal control both in the approving of accounting systems and in the audit program.

Of primary importance in any system of internal control is the plan of organization. Business enterprises today are of such size and scope that the exercise of personal supervision over the conduct of operations is no longer possible. This, of course, is also true of federal government activities. Consequently, suitable organization plans must be developed based on a number of factors such as the type of enterprise, its size, the extent of geographical separation of its activities and many others. The plan should be as simple as feasible; it should be flexible so that changing conditions would not materially affect the arrangement; and, the point we are most concerned with, the plan of organization must lend itself to the establishment of clear lines of authority and responsibility.

An adequate plan of organization should provide for organizational independence as between the operating, custodian, and accounting departments. The basis for this is that no department should control the accounting records relating to its own operations. Failure to provide for a separation between the accounting and operation departments might result in misrepresentations of costs or operating results which would be misleading to management. When the accounting department is independent of operations and has no direct interest in production other than the accurate recording of cost data, there results a series of checks on authorizations and conformance to plans. This separation, therefore, enables the accounting department to present to management the kinds of reports that are required for control of operations, reports which management can accept as completely reliable.

The custodian department should likewise be separate from the accounting and operating departments. This seems fairly obvious when we consider the separation of the cash receipt and disbursement functions from the accounting function. However, the same principle applies to the materials department. The storekeeper should not have access to the records by which his custodianship is to be judged.

The internal audit function should also be separate from the operating departments. The internal auditor should be so placed within the organization that he will have complete freedom to review and appraise the activities of all departments without bias or fear of refusal from any department head.

Accompanying the proper functional separation of activities is the establishing of the responsibilities of each department to permit their efficient operation as a part of the total organizational plan. Further, there should be a clear delegation of authority in keeping with the responsibility assigned. These should be set out in written form available to all who are concerned. In this way each such person will have a clear understanding of his own responsibility and authority as well as those assigned to others.



It is important that within each department responsibility is delegated downward from the department head. These responsibilities should also be set out in writing.

Obviously, the best designed system of written assignments of responsibilities and delegations of authority will breakdown if inadequate attention is given to the personnel factor. First, careful attention should be given to the selection of qualified personnel -- including officers, department heads, and operating personnel. In addition to reviewing technical qualification, consideration should be given to the moral background and character of prospective employees. This can sometimes be adequately taken care of by securing fidelity bond coverage. Secondly, careful attention should be given to adequate training. The employee should be informed of the functions of each of the departments and, especially, of each organizational unit within his own department. Provisions should be made for encouraging employees to prepare themselves for assignment of additional responsibilities by taking special courses of study either by themselves or in group sessions. Thirdly, there should be developed a method for checking on employee performances to determine that the prescribed procedures are being followed. This can be accomplished in a number of ways: by review by supervisors of their subordinate's work; by developing procedures in which the work of one employee serves to check the work of another; or by special devices such as internal audit, standard costs, budgetary controls, and others. Fourth, provisions should be made when practicable for rotations of work assignments from time to time. In some cases this can be adequately provided for through a policy of requiring employees to take variations each year during which time the duties are assigned to some other employee.

A careful selection of employees, adequate training, a system of reviewing performance, and rotation of duties -- these are all important to internal control. Important also is the factor of employee morale. If employees are happy in their jobs -- and this includes "esprit de corps" -- things are less likely to go wrong.

To a very great extent effective internal control is based on the development of an adequate system for recording operations and transactions and for classifying accounting data within a formal account structure. This system works best when the procedures and forms are developed in a written manual available to all employees for reference purposes. Where the organization is a large one, or where the organization is geographically widespread, written procedure manuals are indispensable. Frequently, in smaller organizations procedures are developed without putting them in written form. However, internal control is much improved when this is done, since there is no better way to hold an employee to account than to have a written procedure for him to follow.

Part of an adequate system of recording transactions is the development of suitable forms and the procedures for their approval and logical flow. Forms should, of course, be as simple as feasible so that they can be understood and completed easily and quickly. They should be designed to serve as many purposes as practicable to keep to a minimum the number of forms required. For example: an approved sales invoice may serve as the basis for entry in the accounts, as the shipment authorization, as the basis for preparing sales analyses and summaries, and as the document for computing salesmen's commissions. Forms should also be developed so that proper handling would of necessity provide adherence to the control procedure which has been set up.

Internal check devices we often see in connection with forms are the use of prenumbered forms, copies of different colors to facilitate proper routing, copies having printed routing instructions, and the use of mechanical devices that retain one copy under lock.

The medium for classifying accounting data is the chart of accounts. The accounting system cannot operate satisfactorily without a written chart. A carefully developed chart should facilitate the preparation of financial statements and reports; it should classify accurately the assets, liabilities, revenues, costs and expenses in sufficient detail to be useful to management in the control of operations; it should describe clearly what should be contained in each account; and it should provide controlling accounts when necessary.

In connection with controlling accounts, I would like to make a distinction between controlling accounts and what I call summary accounts. The latter are accounts whose postings represent a summary of the postings made to detail accounts. On the other hand, controlling accounts are those whose entries are made from sources independent of the entries to the subsidiary accounts. For example, the accounts receivable control account would be debited on the basis of total sales on account and credited on the basis of the total cash collections on account. The accuracy of these postings would, in fact, be controlled by the general ledger account.

When adequate procedures and forms are provided for, sound practice in their execution must also be developed. The procedures adopted and reduced to writing should provide the steps through which transactions are authorized and recorded and the custodianship of assets accounted for. Sound practices should provide for assuring the integrity of the authorizations, recordings, and custodianship. Of prime importance is the division of duties and responsibilities between departments as well as within departments. By division of duties and responsibilities is meant providing that no one person will handle a transaction completely from beginning to end. It is here that the small organization presents a problem. Usually, however, there are two or more employees, and a suitable division of duties can be achieved to provide the maximum of internal control under the circumstances.

There are many illustrations that can be developed to show how sound practices serve to strengthen the internal control system provided for in the adopted procedures. Two illustrations should suffice.

There is no area in which sound practices serve more to determine whether satisfactory control exists than in the payrolling process. The procedures provide for the various forms to be used, such as employment and salary or wage rate authorizations, time cards and reports, time tickets, and so on. The punching of time clocks, called for by the procedures, becomes effective internal control only when observed by timekeepers as a regular practice. Job and time tickets should be checked against clock cards and payroll earnings. These checks should be performed by a department independent of those handling the other phases of the transactions. Payroll checks or envelopes should be distributed by persons in no way connected with the preparation of the payroll. Unclaimed checks for envelopes should be held under independent control until called for.



Purchasing and receiving procedures also require sound practices to provide effective internal controls. The purchasing department should purchase only on the basis of written authorization originating in some other department. Receiving clerks should be independent of the purchasing department and should receive all materials delivered. The procedures should call for this, and the forms developed might provide a purchase order form bearing printed delivery instructions. The receiving report and a copy of the purchase order should go to the accounting department where the transaction is entered in the accounts and where independent control is exercised over approval of vendor's invoices. From there a properly approved voucher covering the transaction should be forwarded to the treasurer's department for issuance of the check.

It is relatively easy to take apart some of the aspects of internal control and talk about them for awhile. We should not lose sight of the fact that a system of internal control is a tailor-made proposition, molded to given circumstances. Each part of the system is colored by the other parts and must be merged into a smoothly-functioning whole. A system of internal control is not something to be developed and installed and then left alone. There must be a periodic review made to strengthen the system as changing circumstances make necessary. In short, eternal vigilance is the price of effective internal control.

I hope that as I talked, some of you have been able to envision applications of the principles of internal control to the problems of REA borrowers. The advantages to the borrowers of developing effective internal control systems may be summarized as:

1. More effective control of operations through increased reliability of reports and analyses.
2. The safeguarding of assets.
3. Prevention and detection of fraud and errors.
4. Better audit service at lower cost.-- whether by REA auditors or under the CPA program.

The other day Mr. Wickard mentioned that he felt that the telephone systems to be aided by loans from REA should be modern systems in every respect. I think sound internal control systems should be a part of those modern systems. Your constant efforts toward this end will do much to help REA borrowers and thereby help REA in its fine program.

## APPRAISAL OF INTERNAL CONTROL

### A MAJOR FACTOR IN PLANNING THE AUDIT

Comments Presented by T. A. Hoffman, Audit Manager,  
Division of Audits, General Accounting Office, at REA  
Field Conference, Old Point Comfort, Virginia, June 11,  
1952, and Used as the Basis for a Talk by Richard Platte  
at the Companion Conference in Denver, Colorado.

#### Necessity of Appraisal

In the early days of professional auditing, it was customary practice to make detailed examinations of the records and transactions of businesses. Audits then involved the examination generally of every transaction of the business and a complete check of invoices, payrolls, and other similar original documents, as well as a complete verification of postings to accounts and journals and of footings of the records. In fact, such audits generally entailed a complete tracing of all of the work of the bookkeepers and clerks employed by the organization being audited.

Complete audits were then more within the realm of practicability, and were only possible because businesses were relatively simple, as were their procedures and methods of accounting. Fortunately, in those days taxes were fewer, payroll tax deductions were non-existent, and Government regulations for businesses were less extensive or, in those cases where they did exist, they were less complex. In addition, accounting methods were not so precise in many instances.

In the intervening years, it is well known to all of us how the industry of this country has expanded and developed, not only in the financial and industrial centers, but also in the agricultural areas with which you are most vitally concerned. Business organizations have become more complex; business activities have become more intricate; tax and Governmental regulation requirements have increased; and also accounting procedures and techniques have been developed and refined to produce greater accuracy in financial recording and reporting.

Along with these developments, the field of auditing likewise has undergone a change; more than a mere change, it has been a process of evolution. Today, because of present day business complexities and extents, it is no longer practical for external auditors (or public accountants) to make detailed audits and examinations. To meet these changing conditions, auditors (or public accountants) originally directed their attention to the devices which are known as internal checks, and through recent years have concerned themselves with features of business operations today commonly referred to as internal control -- internal control in its broadest concepts. In making examinations, auditors today are placing more and more reliance upon businesses' systems of internal control, supplemented by test-check and sampling techniques.

If, under these premises, an auditor is to rely upon internal controls, he must know what the controls are, and he must thoroughly understand their



significance regardless of the purpose of his audit. Even if he is undertaking nothing more than a balance sheet audit intended to produce financial statements without a detailed report, the auditor should always examine the methods of control and test their working before he accepts the books as a basis for a balance sheet which he proposes to certify as exhibiting a true and fair presentation of the financial condition of the company. An auditor who has certified a balance sheet which subsequently may be proven to be substantially incorrect, and then seeks to defend himself on the ground that the balance sheet was in accordance with the information and explanations secured by him and was as shown by the books of the company, would find his defense gravely compromised if it were demonstrated that the accounting methods and controls of the company were so lax and inadequate that no reliance could properly be placed on the books.

In addition to this reason for an appraisal of internal control, which reason may appear to be of principal benefit to the auditor, there is another consideration which is of particular importance to the management of any business. An auditor, as a professional accountant, has an obligation to make his work as valuable to the organization concerned as is possible within the limits of the circumstances surrounding his assignment. Experienced auditors acquire extensive experience in various business organizations. This experience should make it possible for them to survey the procedures and controls employed in a given instance and to recognize inefficient, improper, or weak practices and controls which should be brought to the attention of the management for correction or improvement. In addition, the conduct of such a survey itself, aside from the verification of financial transactions and results, and the application of intelligent tests of the working of the accounting system invariably produces a valuable moral effect within the organization.

Some may contend, however, that despite these activities, irregularities and defalcations still will occur. But no one will claim that, just because crimes are still committed, the laws and the police are of no value. (I do not intend to imply, however, that an auditor should be looked upon as a law enforcement officer.)

#### Methods of Appraisal

The usual methods of reviewing and appraising internal controls, as followed in the public accounting profession, involve almost uniformly the use of a questionnaire on internal control. Although there are certain valid objections to the use of any form of check list, it should be recognized that the more serious inadequacies resulting from such use generally are the fault of the individual who uses the questionnaire instead of the document itself. Many auditing organizations have developed questionnaires which approach perfection. From experience, I have seen such questionnaires used with excellent results by Navy Department auditors (cost inspection personnel) who conducted audits in the plants of shipbuilding contractors during the last war. Here, the construction activities were similar for the industry, and contract financial regulations were uniform. Consequently it was possible to develop extremely comprehensive questionnaires which could be used effectively in practically all of the shipbuilding organizations.

More closely related to your work, however, are the activities of certain public accounting firms which audit large numbers of public utility accounts. In certain public accounting firms, particularly in the days of large and complex utility holding company systems, the auditing of public utilities (and public utility accounting) has been regarded as a specialized field. Generally such firms have developed questionnaires for review of internal control which may be used effectively for all of their public utility clients. (I understand that here in REA a project is underway to develop such a form for use in your work.)

The questionnaire, normally, should consist of a series of questions designed to emphasize the functional aspects of the accounting procedures and division of responsibility. Its primary purpose is to establish that all transactions of the business are adequately protected, and it should provide space to indicate briefly what controls have been established, and to indicate clearly instances where controls are weak or inadequate.

Generally such a questionnaire would follow the outline of the balance sheet accounts, but it should also include sections for specific activities such as handling of cash receipts and disbursements, billing of consumers, purchasing, inventories, construction, retirement and maintenance of property, and, in the case of REA borrowers, could well include questions designed particularly to indicate the extent to which the borrowers' procedures assure compliance with REA loan requirements and regulations.

It is desirable that a questionnaire of this nature be designed so that it may be retained as a permanent file document and used in successive audits for a period of years. In this manner complete appraisal of internal controls may be built up over the course of several audits if necessary, each year's findings providing the basis for increasing or decreasing audit scope in successive years. Each year, however, a satisfactory review should be made to determine changes in internal controls, and, of course, particular attention should be devoted to those areas in which deficiencies have been noted during previous years, at least until satisfactory improvement has been attained.

In addition to the use of questionnaires on systems of internal check or control, many auditors use what is sometimes called the procedures review method of appraising controls. In the application of this method, the auditor generally selects certain classes of procedures each of which he reviews thoroughly by reviewing written manuals, discussions with company personnel, personal observations of the working of the procedure or system, and examination of authentic documents which are processed in the particular procedure. This examination is supplemented by various tests such as cross-checks with related procedures, checks of footings, computations and postings, and study of the reports or other results produced by the procedure. Some of this appraisal work is quite frequently performed along with the actual audit. An example of such a procedure might be the payroll system, in which the auditor would examine and trace the mechanics of the operations from the original payroll source, such as daily time tickets, to the final pay-off of personnel. He should not overlook, either, the hiring procedures by which personnel are placed on the rolls and the separation procedures which should effectively insure the discontinuance of payments to a



released employee. This detailed review might well be confined to only one payroll out of the total period under audit. If the auditor's review discloses no weaknesses in procedures, and that all reported costs represent proper payments for services received, he might well be justified in placing reliance on all other payrolls. If, however, he should find reasons to doubt that the payroll reviewed is proper, he would have the responsibility of reporting this fact to the company, and also to extend his audit procedures to the extent necessary to determine the full effect of the inadequacies in the payroll procedures.

In this type of appraisal the auditor generally is required to put forth a greater recording effort than under the questionnaire method. Normally he will prepare a record of the operation of the procedures reviewed in narrative form for incorporation in his working papers. This memorandum will then be retained in his permanent file of working papers for use in designing his audit program, and also for use as supporting evidence to justify the procedures, tests and sampling techniques he may employ in the actual examination of the accounts.

The procedure method has both advantages and disadvantages compared to the questionnaire method of appraisal. The principal advantage, as I see it, is that it requires the auditor to use his initiative and ingenuity and eliminates the danger that he may perform only a perfunctory job in answering his questionnaire. The principal disadvantages appear to be first, the large amount of time and effort that is required in the preparation of the original narratives, second, the possibility that an auditor, due to inexperience, may not recognize significant internal control features or inadequacies which might be listed in advance on the questionnaire form so that he will recognize them in his review, and third, the difficulty of reviewing such narratives in subsequent years, and revising or amending them to reflect changes which may occur.

My personal preference for appraising internal controls is a combination of both of the methods which I have just described, involving principally the use of a comprehensive questionnaire supplemented by narratives on procedures only in certain special or unusual instances. As an example, consider the instance of clearing accounts such as those used for stores expense, and transportation expenses, or the troublesome account in the REA system known as a suspense account. The questionnaire properly could inquire as to whether these accounts are cleared regularly. In this case, an affirmative answer might be assumed to indicate a good situation whereas a negative answer would be considered a bad situation. However, the fact that the accounts are cleared regularly to construction, maintenance or operating accounts does not necessarily prove that the basis used for clearing is a proper one. In this instance, it would appear advisable that the auditor resort to the procedure method, in which he would examine into the propriety of the charges which are accumulated in these accounts, and should ascertain the basis on which the charges are cleared to other accounts and the circumstances which justify the use of this basis. A narrative recording of his findings then should be incorporated in his working paper files to be used as a check on possible changes that may be made by the company in future years.

As an example of results produced by the procedure method, I might mention the case of a certain Government agency which engages in the production and sale of power and performs a large volume of its own construction. In our review, it was found that the agency customarily relieved its administrative expenses of a



portion of such costs which were allocated to its construction activities and capitalized. The allocation was based on a detailed time study made by the organization for a selected month of each year. Although this appeared to be a satisfactory procedure, successive reviews by the auditors disclosed that the organization was using the same month each year since it had assumed that this month was a representative month. As a result of the auditors' questioning, the agency recognized that certain other months of the year might be regarded as equally representative, and that non-representative periods also had an influence on the amount to be allocated. Accordingly the agency adopted the practice of conducting test studies at other periods in order to assure itself that operating costs were not being unnecessarily relieved. The final development in this incident occurred a short time ago when, due to a tremendous increase in the volume of construction without a corresponding increase in administrative costs, it developed that the continuance of the basis of allocation would have resulted in the capitalization of a far greater percentage of administrative expenses than could reasonably be justified. This resulted in a reduction of administrative expenses allocable to other operations that did not appear reasonable. As a result, the auditors suggested that a ceiling be placed on the percentage of administrative expenses that could be capitalized, thereby preventing excessive capitalization of overheads and producing a more accurate picture of the costs of other operations. In all of this problem, the auditor's working paper memorandums relative to the agency's procedures were of valuable use in disclosing the situation which developed, and in arriving at a proper solution.

#### Internal Control Considerations in Planning an Audit

There is no hard and fast rule requiring the application of certain audit procedures because of an auditor's findings in his review of internal controls. Each plan of audit requires the exercise of professional judgement in relationship to the auditor's appraisal of the procedures and controls in effect. In its statement of "Auditing Standards", the American Institute of Accountants has stressed this point in the following quotation:

"The independent auditor must also exercise this best judgement in determining the scope of this examination and in deciding whether the interests of stockholders and creditors justify the time and expense involved in the extension of any particular line of inquiry....It is the duty of the independent auditor to review the system of internal check and accounting control so as to determine the extent to which he considers that he is entitled to rely upon it. To exhaust the possibility of exposure of all cases of dishonesty or fraud, the independent auditor would have to examine in detail all transactions. This would entail a prohibitive cost to the great majority of business enterprises--a cost which would pass all bounds of reasonable expectation of benefit or safeguard therefrom, and place an undue burden on industry.

"It is worthy of repetition that the extent of sampling and testing should be based upon the independent auditor's judgement as to the effectiveness of internal control, arrived at as the result of investigations, tests, and inquiries. Depending upon his conclusions in this respect, the independent certified public accountant should extend or may restrict the degree of detailed examination."



I recognize that much of this is theoretical and therefore it seems desirable that we should get down to some specific cases which may apply to your auditing work. I have reviewed the REA "Handbook for Field Auditors" and I believe that it contains an excellent presentation of standard audit procedures and of related internal control features that should be considered. It is therefore difficult to mention points which may add to your information, however I have noted a few items which may be helpful to you in planning and conducting your audits. You should bear in mind, however, that these are personal ideas, and they do not necessarily represent the official opinion of REA or of the Department of Agriculture.

### Bank Reconciliations

Under the description of an effective system of internal control for cash, it is stated that "Bank statements should be carefully checked each month and should be reconciled with the book accounts by a different individual from the one responsible for making deposits and drawing checks." The related audit procedure subsequently described is to "Obtain all bank Statements and cancelled bank vouchers for the period under review and reconcile bank balances as of the audit date with the amounts reflected in the related cash accounts in the general ledger." Here, I believe, auditors might save some time and effort through effective appraisal of control methods. Aside from the recommended internal control points, it would appear that the auditor should determine what controls are exercised over the company's bank reconciliations after they have been made by the individual whose duties are separated from those of the cashier. In this respect, it is desirable that, in addition to the independent reconciliation, the original reconciliation records of the company be maintained under control so that the cashier does not have access to them at any time. There is no objection to furnishing the cashier with copies of the reconciliations if needed by him; however, if all reconciliation records should be made available to the cashier, there would be no effective control over cash from this standpoint.

However, if the auditor should find that the reconciliations have been prepared independently and that the original reconciliation work sheets are kept under proper control, it is reasonable and proper for him to place reliance on this control procedure, and to eliminate from his audit program the preparation of bank reconciliations independently by him. Rather he would be justified in using the company's official reconciliation files for the purpose of making checks and tests to determine that the bank accounts have been reconciled properly and that all reconciling items have been shown correctly, and represent proper outstanding items at the balance sheet date. To establish proper support in his own working papers, the auditor may obtain copies of the company's reconciliations on which he may record the procedures followed by him in verifying their accuracy. Such a procedure will produce a substantial savings in audit time as compared to a procedure where the auditor prepares bank reconciliations on a completely independent basis.

### Accounts Receivable

The importance of proper controls over accounts receivable, billings, and collections cannot be overemphasized in your work because all, or substantially all, of the borrowers' revenues are accrued through these accounts. Through a proper analysis and examination of the accounts receivable accounts, it is possible to trace nearly all revenues of an electric borrower through accounts receivable accounts to final collection or other disposition.



In verifying account balances at a given date, however, it should be recognized that the number of utility accounts represents a substantial bulk of items and, therefore, that to verify each account is a time consuming process.

I refer to the audit manual procedure which instructs auditors to confirm balances in the accounts receivable ledgers to the extent deemed necessary. In developing adequate audit procedures for accounts receivable, the auditor should concern himself with the character of the accounts as well as the controls. Ordinarily it is found that residential accounts and other small accounts which represent the greatest volume are more susceptible of routine procedures which afford adequate control. In addition, the large volume of these small accounts, in money, may represent but a small portion of the value of all accounts if the borrower has other accounts with industrial, municipal or other large consumers.

The large accounts are generally with organizations that maintain adequate records and therefore are in a position to express a reliable confirmation of the correctness of the charges made against them; however the computations of charges for service rendered these customers sometimes are complicated by power demand and other technicalities which are difficult for the average auditor to test check. Sometimes each large account is covered by a contract designed only for its particular circumstances.

Because of these features, the auditor usually cannot rely on internal controls over the large accounts as greatly as he can with respect to the smaller accounts which follow a uniform pattern. Accordingly, in laying out accounts receivable confirmation procedures, I believe the auditor should consider a rather extensive coverage of industrial and other large consumers' accounts.

For the smaller accounts which lend themselves to relatively simple and repetitive operations, the auditor should concern himself primarily with ascertaining whether the system of internal control is adequate, and his confirmation procedures should be limited, in most cases, to a relatively small test to determine that the system operates properly and provides adequate protection.

In REA, I have always been intrigued by the self-meter-reading and self-billing procedures followed by some borrowers, since this practice is not common in the privately-financed electric utility industry. Where such a procedure is followed, the auditor should consider control features necessary to adequately protect the borrower. In both self-reading and self-billing, there should be an adequate periodic check by borrower representatives on the figures reported by consumers. In this check, also, the principle of rotating the representatives who make the checks should be considered so that incorrect or improper reporting will be disclosed within a reasonable period. Without these safeguards, the auditor's job is difficult. Obviously, a confirmation received from a consumer who knowingly has reported incorrectly is valueless.

To overcome these obstacles, the auditor should employ other techniques and examine into other controls that may exist. If self-reading or self-billing is employed, the auditor should concern himself with the borrower's records on system energy in-put, total KWH sold, other dispositions, and line losses. If he can satisfactorily account for the distribution of the system in-put through billings to consumers, he will have a basis for limiting confirmation and other work on accounts receivable. Likewise he should determine whether the borrower has



adequate records on and control over consumers' meters to assure that energy bills are rendered for all meters in service, and that meters reported as not in service are satisfactorily accounted for. Here a monthly meter report which may be reconciled with the total number of consumers billed may be used by the auditor as a basis for limiting his receivable verification work. (I have seen several instances where public utility employees have conducted a profitable personal utility business on the side, simply because their employers did not control and account for all meters owned by the company.)

### Materials and Supplies and Purchasing

For this item, I will diverge a bit and tell you about an auditing and internal control problem encountered in my own work. In the past, the General Accounting Office has made what was known as a centralized audit of Government accounts which involved the forwarding of paid original documents from the agencies to GAO, where the documents were audited and retained. Under recent auditing and accounting developments this type of audit is being eliminated and replaced by a site audit or comprehensive audit, thereby permitting the agencies to retain the original documents which previously had been forwarded to GAO. Under the old audit procedure, there was adequate protection to the Government against duplicate payments, made erroneously or otherwise, since agencies were restricted to making payments only on original documents, and when once paid, the documents went out of their possession. Consequently there was no urgent need for invalidating documents when paid by the agencies. Under the new procedures, however, GAO auditors have found that some agencies, being accustomed to the old procedures, have failed to cancel paid vouchers which are now retained in their files. Such practice, obviously, provides inadequate control and protection against erroneous or fraudulent duplicate payments.

Both the Accounting Systems Division and the Division of Audits of GAO have conducted a vigorous campaign to now require agencies that are placed under the decentralized type of audit to cancel, upon payment, not only the paid invoices, but also all supporting documents such as purchase orders and receiving reports. This practice permits the auditors to place greater reliance on the agencies' records and accounts than otherwise would be possible. Equally as important, it affords the agencies a proper protection over disbursements for which they are held accountable.

### Construction Accounts

Construction accounts could be the subject of a very lengthy discussion, however, I will mention them only briefly. From my experience, it appears that borrowers' construction has been supervised closely and quite adequately by REA through various loan regulations and through the activities of REA engineers. Here it seems that REA auditors have an opportunity to reduce their audit efforts substantially if an adequate understanding of REA's construction supervision procedure is obtained by the auditor, and a thorough review is made of the borrowers' compliance with the requirements. I believe that the controls existing normally are such that a substantial amount of property account analysis work now performed is unnecessary. Construction project close-outs and work orders are subjected to close REA engineering examination and approval. This control feature should be relied upon to the fullest extent possible, which I believe would free the auditors for doing some constructive and practical audit work which I will now discuss,

## Operating Accounts

I will frankly tell you that I have always been somewhat concerned over the REA audit of borrowers' revenues and expenses. I recognize that REA has management and other experts to analyze operating trends, however it seems to me that an auditor cannot satisfactorily determine what his audit coverage should be unless he also gives some attention to the study of operations.

To know that operating revenues or expenses have increased or decreased a certain number of dollars and a certain percentage, and that various expenses constitute various percentages of gross revenues is interesting. However, the reasons why these increases and decreases have occurred is not only more interesting, but must be known to determine where audit effort should be emphasized.

Since all revenues come from consumers, the maintenance of consumer statistics by the borrower is important. In analyzing revenues, I think the auditor should consider how the revenues have been produced and why a year's revenues may have changed as compared to the previous period. He will find that revenues change because of changes in the number of consumers, because of changes in average consumption of electricity, and because of changes in rates.

I believe that audits of your borrowers should include such a study as a basis for extending or limiting audit procedures.

For example, assume that during a given year 1,000 customers using an average of 1200 KWH per year at a rate of 4¢ per KWH produced a total revenue of \$48,000. In the next year, assume that revenues reported for this class of consumer total only \$36,000., a 25% reduction. Consequently, if average consumption per consumer has remained constant and there has been no change in rates, it would appear that the number of consumers has decreased by 25%. If this not found to be the case, then the auditor needs to do some extended work on accounts receivable and revenue verification.

Similar tests, it seems, should be applied by auditors to expenses, such as power purchased, fuel purchased when borrowers operate generating plants, and other expenses. Maintenance cost variations should be reviewed to determine whether unusual climatic conditions or other factors have existed which can reasonably account for the changes.

This may seem to get away from internal control; however, I suggest that if the information desired here is regularly produced by the company, then these are features of internal control which the auditor may well use in considering the reduction or increase in the scope of his audit. Many auditors ordinarily consider that by analyzing balance sheet accounts and by tying-in the related accruals to the various income and expense accounts, they will have accomplished a satisfactory audit. This is not always true, but if such a procedure is a proper way to verify operating results, then it seems that a reverse procedure of starting with a verification of operating accounts, and procedures particularly, and then working back to prove debit and credit items in the balance sheet, also should be effective.



The point I want to make here is that I believe that audit efforts, when based on an adequate appraisal of internal controls in effect, can be more effectively applied if the emphasis is taken off the meticulous verification of minor account balances in the balance sheet and is directed towards obtaining a comprehensive knowledge of underlying procedures and accounting results.

Let me give you one more example before I leave this item. I believe you realize that current operating problems of borrowers have been receiving more attention from REA engineers in the last year or two. The major construction phases have become substantially completed, but now as electric systems operate and grow older, the question of maintenance becomes extremely important. This probably will be an increasing item of expense in the operating accounts.

In making analyses of maintenance accounts and similar operating costs, much time can be wasted by preparing lengthy schedules which show only the distribution between labor, materials and other charges. Analyses of this type should be avoided. It is much more important to determine the nature of the maintenance work done and the company's basis for the distribution of charges as between operation, maintenance and replacements, particularly where work involving all of such items is concerned.

### Working Papers

I have been asked to comment on working paper documentation in connection with appraisals of internal control by auditors. Preparation of proper working papers is a challenge to any auditor, and only the best auditors can meet this challenge successfully. More frequently it is found that auditors either accumulate too many working papers containing useless information, or present papers that are too brief to offer conclusive evidence that they have made a complete and satisfactory audit. Too seldom do we reach that degree of fineness that produces a complete and concise documentation with a minimum of time and effort.

I have commented upon the use of a form of questionnaire on internal control and upon the preparation of working paper memorandums in connection with the procedure review method. Evidence of internal control appraisals, however, should not be confined to these two portions of an auditor's working papers, but, wherever practical and required, such evidence should be recorded on individual schedules and work sheets.

All auditing organizations are constantly faced with the problem of proper working papers. For example, one firm performing a large amount of public utility work once wrote a memorandum to its staff cautioning them on certain instances noted in reviews of public utility working papers where procedures could be made more efficient. Some of the points mentioned are these:

- A. "Working papers are weak in that account explanations, memoranda on procedures followed and conclusions reached are either too condensed or too involved to be of maximum value. More stress must be laid upon putting concise and understandable data in working papers. The working papers should indicate the source of data and the extent to which it has been checked by us."

- B. "The work on property accounts is often poorly planned with the result that unnecessary detailed analysis is done. In many cases too much emphasis has been placed upon analyzing a large percentage (in dollars) of the total construction and too little upon determining accounting policies followed in connection with blanket work orders, etc. Frequently too much of the property analysis is turned over to inexperienced juniors. It has been noted that work order analyses often contain lists of small items not vouched or verified which might better be grouped into one total.
- C. "It was noted that many unimportant balance-sheet accounts, such as minor prepayments and deferred items, both debit and credit, are unnecessarily being analyzed by months. In most cases a determination of the theory of the account, what the balance at the end of the period represents, and the company's proposed disposition thereof, together with a statement indicating the insignificance of the total debit and credit transactions in the account, are all that are required. In this connection, of course, the relative significance of the account should be measured, not by the balance at the end of the period but by the volume of transactions during the period.
- D. "More emphasis must be placed upon principles followed by clients in their use of clearing accounts. If this is done, less detailed analysis may suffice. In recurring annual examinations, analyses of such clearing accounts as transportation expense, tool expense, supply expense and house service expense often may be limited to a summary of the monthly debits and credits, with a detail analysis of one or possibly two months of the charges and credits thereto. If the method used in clearing the account has changed during the year, the change should be noted and investigated.
- E. "More attention should be given to the proper costing of merchandise selling expense in relation to similar items, if any, charged to regular utility operations. Items which are often distributed arbitrarily as between merchandise and jobbing and utility operations are merchandise supervision, salesmen's salaries and commissions, rents, purchase and warehouse expense, provision for uncollectible accounts and general bookkeeping. We should determine that merchandise and jobbing revenue is stated on the basis of proper accounting principles."

You will probably note that these illustrations are directed at saving time and effort as well as at the accomplishment of a more effective audit through the examination of the purpose and effect of accounting procedures. Professional accountants must keep audit costs down to a practical level to stay in business, and likewise they must perform effective audits. You have similar responsibilities to your employer, the Government; namely, responsibility to produce the most effective audit possible at the lowest possible cost to the taxpayers.

#### Audit Reports

The last item I have to comment upon is the subject of audit reports. I believe that your present reporting policy provides for reporting, under the general comments section, the more significant matters regarding procedures and internal control in the audit reports. These comments, I believe, should be confined to those items which might have a substantial or serious effect on the financial position of the borrower. Other items, however, provided they are not trivial,



also should be reported to the borrower to make them matters of official record and to make it possible for the borrower to receive the maximum benefits of the audit. Many professional accounting firms regularly follow the practice of summarizing their findings and their appraisals of internal control, and after each audit they furnish their clients with a letter pointing out instances wherein controls may be strengthened and economies may be effected.

In REA it appears that this kind of reporting is mostly done on an informal basis. Consequently, there seem to be instances where not positive record of such findings and reportings have been made. I do not wish to make suggestions that might overburden field auditors with the preparation of special letters and reports in addition to the audit reports; however I believe that improvement might be possible in this direction without imposing an additional burden.

My suggested solution here is relatively simple. Briefly it would involve the preparation of such letter reports or memorandums to borrowers in the central office in Washington where such work could be handled efficiently by a special staff. To make this possible, however, field auditors would have to lend a hand in the preparation of adequate, understandable working papers from which the reports could be prepared.

Working papers may be considered as the raw material from which auditors' reports are prepared. The papers represent the connecting link between the books, records, policies, procedures, and internal controls underlying the financial statements examined and the audit report submitted to the borrower. Working papers constitute the only proof of audit work performed, as well as the record of audit findings and conclusions. An auditor should look upon each work sheet as a separate report to his superior on the audit task assigned to him. Working papers can stand the test only if a superior can take the papers prepared by an auditor and prepare an audit report from the working papers without asking questions. If your working papers can stand this test you will have done a proper job.

Whether the report is prepared by a superior or by the auditor himself, there should be no difference in the preparation of working papers, conduct of the audit, or appraisal of internal controls. An auditor does not perform these functions solely for the purpose of reporting to himself. Others must rely on his work.

I commend the general policy adopted by REA in its audit work--a policy intended to produce conformance with professional accounting and auditing standards and procedures as nearly as may be practical. In this respect, I feel it is proper to call to your attention the standard wording for your audit reports which has been adopted from the public accounting profession:

"Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances, and included such tests of the accounting records and other supporting evidence as necessary to determine the effectiveness of the internal check or control maintained by the borrower, and such other procedures as we considered necessary."

That is a large and important statement. The reader of such a statement immediately has a right to consider that you possess competence in auditing and accounting techniques, and to rely upon your skill, your judgment and your integrity.

integrity. REA borrowers and your superiors and officials in REA rely upon that statement. The Government and the taxpayers also rely upon it, and we in the General Accounting Office, as their auditors, hope that our reviews will prove that it can be relied upon.

In making that statement, however, you must accept the responsibility that goes with it. You have stated that you have met standards of auditing procedure that will justify you in saying that the financial statements "present fairly" the information furnished to the reader of the report. You have stated also that in selecting these auditing procedures you have exercised your best judgment based upon a personal review and understanding of internal controls and procedures, and that you have designed your audit work to fit the conditions existing in the particular audit assignment. You must be prepared to prove these statements, not only to yourselves, but to all others concerned.

If you plan your tests of the accounting records and other data carefully, based on an intelligent appraisal of the systems of internal control, you will provide a high degree of assurance as to the reliability of the financial statements. You will also place yourselves in position to make more effective and more efficient audits, in keeping with the best interests of the Government.



OBJECTIVES, PLANS AND PROCEDURES OF THE EXAMINATION  
PROGRAM

Talk by Robert A. Stein at the June, 1952  
REA Field Conferences

Return to the  
Division

In returning to the Accounting and Auditing Division, henceforth the Division of the Controller, I find it a real pleasure again to be associated with friends and acquaintances of former years, <sup>most</sup> those who have come into the division since I left, and to look ahead to the accomplishments which are anticipated for the Examination Group of the division. I would like to emphasize the tremendous task which we face in effectively discharging the responsibilities which the Administrator has seen fit to give to us in the reorganization. The job can be accomplished only through the co-operation of the entire staff, with a great deal of the load necessarily resting on those staff members who will be on the firing line, making examinations. Your co-operation and best efforts are earnestly solicited in meeting the challenge ahead--that of rendering protective and constructive help to the administration in discharging program responsibilities in the most effective and efficient manner.

Preparing for Our  
New Responsibilities

Mr. John Cooper has given us at the conference (at Old Point Comfort) some very sound and basic information concerning the internal audit approach and I am sure has been extremely helpful to all of you in your attempts to visualize just what will be expected of you as internal auditors. Messrs. Nolan, Hoffman, (at Old Point Comfort) Selinsky, and Platte (at Denver) have presented valuable guidance on the subject of internal control which I feel sure will greatly assist you in completing more satisfactory audits in less time. The adequate fulfillment of your responsibilities as field examiners under the new concept depends to a great extent upon the application of principles and philosophy you have heard expressed. Without a thorough understanding of internal control and the evaluation thereof during an audit for planning the execution of the audit work, your performance is not likely to meet the professional standards which will be expected of REA examiners. Likewise, it will be most difficult to obtain expected results in the evaluation of REA's relationships with borrowers without having a thorough understanding of the concepts of internal auditing. The point I am trying to make is that each of you must take to heart and apply in your daily work some of the concepts brought out by the men who have spoken at the conference on internal auditing and internal control.

Training Plans

We must realize that the presentations at the conference are merely the Kick Off to the new approach and that much study and self improvement on the part of all <sup>of</sup> us will be necessary to gain the background required to do an effective job for REA. It is anticipated that considerable emphasis will be placed on training our examiners to this end during the months immediately ahead. As a first step, we plan to make available to you in some form all possible information on the subjects of internal auditing and internal control, including copies of the talks you have heard here.

We are at present in the process of developing some internal control check lists for use in appraising the borrowers' internal control systems. In fact, we

are going to make every possible effort to have policies and procedures relating to the new concepts developed and in your hands so that a training conference may be held before the end of the calendar year. I might add that we may also give you an examination covering both internal auditing and internal control at about the same time, or perhaps a little later, depending upon when we can get sufficient information in your hands. We are expecting every examiner in the field to have proper understanding of the new approach.

Tentative Plan of  
Field Operation

Although we have not as yet worked out all of the details of the proposed plan of field operations of the Division of the Controller, our preliminary studies have indicated that the following basic procedures will be established for accomplishing the examination program.

1. Unless otherwise directed by the Administrator the examination manager will collaborate with the line organizations in developing an annual schedule of REA operations audits, CPA audits, REA construction audits, and special audits, and, to the extent possible, a program for the assignment of field examiners to render accounting advice and assistance.
2. In order to have current information on which to base recommendations for a schedule of various types of audits, the examination managers will obtain about May of each year the recommendations of the examination supervisors with regard to the scheduling of audits for the new fiscal year. The examination supervisors are to present the basis for their recommendations, such as information on travel required, economies expected, etc.
3. Within the framework of the annual schedule of audits as agreed to by the examination managers and the line organizations, the office of the examination manager will develop specific assignments for the field examiners, giving consideration to all pertinent information available in the Washington office. The partially prepared assignment sheet will be forwarded in triplicate to the appropriate examination supervisor, together with the field file relating to the particular borrower. (This file will be maintained in the Washington office of the examination manager throughout the year until such time as it is appropriate to forward it to the examination supervisor for his use and for transmittal to the field examiner. The field examiner will of course return the file to the examination supervisor with his completed audit report for ultimate forwarding to the Washington office.)
4. The examination supervisor will review the specific assignment prepared in the Washington office, add to it any comments he feels appropriate, designate the estimated dates of the assignment, affix his signature, forward the original to the field examiner, retain a copy for himself, and return one copy to the examination manager. This same procedure will be applied to the making of accounting advice and assistance (AAA) assignments. In case such assignments originate in the field, the supervisor or the field examiner will prepare the three copies of the assignment schedule and see that they are properly executed and distributed.



5. If minor adjustments are necessary in the annual schedule of audits, the examination supervisor will exercise responsibility for adjusting such examination schedule in collaboration with the responsible representative of the line organization. When such adjustments are made, examination managers must be promptly notified and advised of the reasons therefor.
6. The examination manager will keep currently informed as to the status of the examination program and will have letters prepared for release by the Washington offices of line organizations notifying borrowers approximately 30 days in advance that audits are to be made by REA examiners.
7. The examination supervisor will endeavor to visit the examiners on the job during as many of their audits as possible, preferably near the conclusion of assignments, to review work accomplishments, render advice and assistance as necessary, and to assure that the examination is sufficiently wide in scope and is professionally performed in a manner which will accomplish the overall objectives of the examination program. This includes a preliminary review of the examiner's contemplated report for adequacy of coverage, soundness of recommendations, general tone, reliability of information presented, conformance to accepted standards of accountants' writing, and other qualities of good reports. Supervisors' visits of this type during an examination need not be cleared with representatives of line organizations.
8. Under special circumstances, such as where unusual conditions exist in borrowers' offices, or where examiners are expected to require special assistance, examination supervisors will make surveys of borrowers' records for the purpose of ascertaining the status of the records, outlining for line organizations recommendations for improvement where necessary for examination purposes, and suggesting to the examiner assigned the type of examination program required under existing circumstances. All such pre-audit visits to borrowers by examination supervisors will be cleared with responsible representatives of line organizations.
9. During supervisory visits when examinations are in progress, the examination supervisor will participate with examiners in conferences with borrowers' officials and personnel by which such representatives of the borrower are informed of examination findings and of recommendations being made to REA with reference to matters covered in the examination.
10. Field examiners, in carrying out examination assignments, will prepare such adjusting journal entries as they feel appropriate to correct borrowers' records and to assure presentation of the actual financial condition. Such journal entries will be discussed with the manager and/or the bookkeeper and will be presented to the latter for incorporation in the general books of the borrower. As in the past, the examiner is to observe that the entries are placed on the books before he departs from the borrower's office.
11. In making adjusting journal entries during examinations, field examiners are to keep in mind the objective of making only such adjustments as are required to cause the books to reflect actual conditions in accordance

with approved accounting principles. They should avoid making trivial adjustments which would not be significant in relation to showing a proper statement of financial condition. Likewise, adjustments designed solely to illustrate accounting principles or procedures should not be made.

12. During the course of audits field examiners should take note of, and report to their supervisors, any types of accounting advice and assistance which they feel should be recommended to the line organizations for performance on behalf of the borrowers. In case of the discovery of dire need for technical assistance by borrowers in the establishment or maintenance of accounting records, the examination supervisor should not wait for the report to be forwarded to Washington, but should telephone the responsible field representative of the line organization and inform him of the situation. Furthermore, if there are any matters, accounting or otherwise, which appear to demand the immediate attention of the Washington office of the line organization, the field examiner is to cite them in a memorandum to the examination manager (with a copy to the examination supervisor) in order that they may be brought to the attention of the line organization at once.
13. The examination or audit report and all related papers are to be forwarded immediately upon completion of the examination to the examination supervisor. The latter will review examination reports for conformance with examination policies and procedures, adherence to professional standards and to instructions previously given, and for soundness of recommendations and adequacy of supporting working papers. He will take appropriate action to have reports corrected or improved as necessary. Reports determined to be in proper order are to be forwarded to the examination manager for consideration and processing in the Washington office. Such reports are to be mailed to Washington by the examination supervisor within five working days after his receipt of them from the field examiner.
14. Upon completion of the review of the examination report in the office of the examination manager, the report will be signed by the examination manager and forwarded to the appropriate line organization or office, together with a covering memorandum dealing with important items in the report and a rough draft of a proposed letter to the borrower from the line organization transmitting copies of the report.
15. The examination manager will forward the field examiner's copy of the examination report, together with review comments and rating sheet, to the examination supervisor who will transmit it to the field examiner.
16. The examination supervisor will collaborate with top field personnel of line organizations in arranging for visits of examiners to borrowers' offices to lend special accounting advice and assistance, as directed from the Washington office.
17. The examination supervisor will continuously direct and supervise at the field level a program for the self-improvement of examiners as a means of assuring growth in their capacities and the achievement by them of top professional standing.



18. The examination supervisor will continuously employ systematic methods of ascertaining whether or not subordinates are conducting themselves in accordance with professional standards of conduct and in compliance with governing policies and procedures relating to hours of work, leave, travel, and other matters of a similar nature. They will carry out appropriate action in cases involving non-compliance with proper standards of conduct.
19. Examination supervisors will be expected to maintain satisfactory public relations with borrowers, borrowers' organizations, other representatives of REA, certified public accountants, state regulatory bodies, and others with whom they will have dealings, as authorized.
20. Upon specific assignment, examination supervisors will conduct the most difficult examinations of borrowers' records involving unusual problems, matters of exceptional interest to the agency, or situations requiring the highest level of professional ability available within the field staff.
21. Examination supervisors will represent the Division of the Controller at the field level in discussions with certified public accountants on technical accounting and auditing matters.
22. Examination supervisors will establish official headquarters at a point within the assigned area which will permit most effective communications and travel with respect to their duties and where the preponderance of the workload is to be centered, such headquarters also to be designated in accordance with the applicable regulations of the Bureau of the Budget governing official travel.

## SERVICES OF THE TECHNICAL STAFF

Summary of a Talk Given by Kenneth L. Smith at the June, 1952 Conference at Old Point Comfort, Virginia, and by Keith H. Kittle at the Companion Conference in Denver, Colorado.

The work of the Technical Staff falls into three main categories, as follows:

1. Assistance on modernization and conversion of REA's internal accounting system.
2. Handling special assignments for the benefit of borrowers in the electrification and telephone loan programs and assisting or advising other REA divisions.
3. Reviewing and revising accounting and auditing procedures affecting borrowers.

In connection with the first, two staff members are presently assigned to the modernization and conversion work on REA internal accounting.

By giving preference to special assignments which arise constantly, we feel we have rendered a valuable service to REA borrowers and to other divisions. Some of the more important special problems handled since last October are the following:

1. Assistance to Sho-Me Power Corporation on income tax problems.
2. Special studies to assist field auditor in disposing of unusual accounting problems of Kamo Electric Cooperative, Inc., relating to lease agreements and accounting for overhead costs.
3. Making special studies and recommendations concerning the complex financial affairs of Alaska IIA Annette.
4. Serving on special committee appointed to study state commission problems in the telephone program and drafting proposed manual on rate case work.
5. Special review of the purchase agreement and audit relating to acquisition of Colorado Utilities Corporation.
6. Study of accounting problems arising from postage stamp rate in Nebraska Public Power System.
7. Examining and analyzing special reports on defalcation at Minnesota 93.
8. Preparing article for publication on audits by certified public accountants.
9. Reviewing certain account/ing and financial provisions in proposed standard telephone loan agreement.



10. Cooperating with Power Management Section in analyzing proposals of Dairyland Power Cooperative concerning accounting for depreciation and replacements and handling of related funds.
11. Meeting with officers of SPA and GRDA, respectively, to discuss accounting problems affecting borrowers.
12. Attending regional meetings of NRECA, independent telephone associations and interim conferences.
13. Serving on REA Capital Credits Committee. A tremendous amount of work remains to be done on Capital Credits Accounting problems.
14. Assisting on form of joint operating agreement between telephone and electric cooperatives.

The foregoing do not cover smaller routine matters on which advice and assistance have been given to A & A Section Heads and personnel of other divisions.

In addition to handling special problems, Mr. Russell in the past has devoted considerable time in line work in the telephone loan program.

Most of the foregoing special problems have been completed or are nearing completion. There is in progress, however, an assignment relating to revision of the form of the REA Annual Statistical Report, including cooperation with the Federal Power Commission Staff.

In accomplishing a fairly satisfactory disposition of special assignments, we have had to defer important work on accounting and auditing procedures affecting our borrowers.

The more important phases of this backlog are:

1. Plant Accounting.
2. Depreciation Accounting.
3. Review and possible revision of auditing procedures and form of report.
4. Revision of accounting and auditing memoranda, interpretations, staff bulletins, etc.
5. Devising suitable internal control procedures for borrowers.
6. Capital Credits Accounting.

The Plant and Depreciation Studies are closely related. In connection with plant accounting we are re-examining the lists of retirement units in order to attain the necessary uniformity with the electric industry and other agencies. When this is done we should devise a suitable system of continuing property records for our borrowers. In recent weeks some progress has been made in preparing a list of retirement units in the work of the REA Depreciation Committee. We are serving as members of the main committee and as technical advisers to the auxiliary committees studying depreciation rates on production, transmission and distribution properties.

We have prepared the first draft of a general plan on continuing property records to recommend to our borrowers, but much work remains to be done on the forms and other details. This will logically follow after the list of retirement units has been perfected. There is considerable pressure from borrowers for REA to decide on a form of continuing property record and to render assistance in that regard.

It is essential that certain procedures followed by REA auditors are carefully reviewed. One of the most important is the auditor's evaluation of the system of internal control used by borrowers. Another is the procedure for verifying inventories of materials and supplies. Our procedures all should be reviewed in the light of changes in professional auditing standards in recent years. We should also consider the possible use of standard forms for auditors' workpapers.

The form and content of the audit report should be reviewed and modified. The suggested audit program for certified public accountants examining the books of REA borrowers is now being reviewed.

Certain accounting and auditing memoranda of the new series have been released to borrowers. However, there are others which require attention in the near future. For example, SL-23 covering interpretations of REA accounting should be revised and obsolete material eliminated. We should clarify the accounting for removal of lines from military areas, and review the accounting procedure for installation loans and attempt to simplify such procedures. The manual of work order procedure is under revision and requires considerable work.

We have done some research of proper standards of internal control for our borrowers. This is believed to be a very important phase of our obligation to borrowers, neglect of which might prove to be very costly to the government and injurious to the REA program generally. It is obvious that many of the small borrowers need considerable guidance concerning proper controls over the receipt and deposit of cash, accounts receivable, materials and supplies and even, in some cases, over cash payments.

Complex problems arise continuously with respect to accounting for capital credits.

The technical staff participates in the regular meetings of the Capital Credits Committee, and we have made reasonable progress in our attempts to meet the accounting problems inherent in capital credits. The more pressing items requiring attention in the near future are:

1. Relation of non-operating margins to capital credit assignments.
2. Accounting for capital credit certificates and consumer refunds received by REA borrowers.
3. Basis of assigning capital credits to large-power consumers.



## TELEPHONE ACCOUNTING AND AUDITING

Summary of Talk Given by Virgil P. Russell at  
the REA June, 1952, Field Conference in Denver,  
Colorado

### Systems of Accounts

After the Rural Electrification Act of 1936 was amended on October 28, 1949 to provide for the improvement and expansion of rural telephone service the Accounting and Auditing Division made the first balance sheet and installation audit in October, 1950 of the Fredericksburg and Wilderness Telephone Company, Chancellor, Virginia. As of June 15, 1952, 102 balance sheet and installation audits have been made and 8 operations audits. Total advances made to sixty-one telephone borrowers as of June 18, 1952 amounted to \$7,413,048.51.

An administrative decision was made March 26, 1951 to the effect that in all cases where the borrower is an existing telephone organization the Accounting and Auditing Division will arrange for an audit to be made of the borrower's records prior to release of first advance of loan funds. In every case an audit has been made of an existing telephone organization with no delay prior to authorization of the first advance of funds.

Other than the auditing of membership fees, the only balance sheet audit that is made of newly organized cooperatives is in cases of an acquisition of an existing telephone company. Otherwise, the auditor instructs the borrower in the use of the budgetary control system and the filling out of the Financial Requirement Statement and Expenditure Report and renders any other accounting assistance necessary. In all cases where personnel has been available the auditor returns generally in 60 or 90 days to determine if the borrower is maintaining the accounting records properly and give any advice and assistance required.

The application of systems of accounts for REA telephone borrowers was fully explained in two training courses conducted in Washington last fall and is covered in Administrative Bulletin No. T-1. For the benefit of field representatives who may not have attended the training courses, I will give an explanation of this subject. The Uniform Systems of Accounts as prescribed by the Federal Communications Commission for Classes A, B, C, and D telephone companies have been adopted as the basic systems of accounts to be followed by borrowers of REA loan funds for telephone facilities unless they conflict with a state regulatory body's accounting rules and regulations, in which case the borrower shall keep its accounts and records in conformity with the accounting system prescribed by such body.

There are state regulatory bodies in all states with the exception of Texas and Iowa. Twenty-six state regulatory bodies have adopted the FCC Uniform Systems of Accounts in their entirety.

Regulatory bodies in the states of New York, Ohio and California prescribe their own systems of accounts for all classes of telephone companies and such systems are based on the FCC system. The remainder of the states generally have adopted the FCC system for class A and B telephone companies and prescribe their

own system for class C and D telephone companies and some states prescribe a system for class E telephone companies based on annual operating revenues not exceeding 12 to \$15,000.00.

In the Two states previously mentioned that do not have a regulatory body, REA borrowers will follow the FCC system of accounts. State regulatory bodies adopted the FCC Uniform System of Accounts for telephone companies for intra-state operations for convenience purposes due to not having sufficient staff to write their own systems. With the exception of subsidiary companies to the Bell System only telephone companies which operate inter-state report to the Federal Communications Commission.

Generally, the state regulatory bodies, due to limited personnel, do not exercise jurisdiction over small telephone companies with the exception of applications for increases in rates, service complaints and annual reports.

The determination of the class of uniform system of accounts for telephone companies to be applied to an REA borrower is made from the estimated annual operating revenues of the borrower which are indicated in the feasibility study prepared by the Applications and Loans Division and attached to the copy of the loan recommendation signed by the Administrator. The estimate of annual operating revenues is made by projecting the number of potential subscribers' stations installed and in operation subsequent to completion of the new telephone plant.

We have found generally that the accounting records of REA telephone borrowers are inadequate and the personnel maintaining the records in many cases have little knowledge or experience in accounting. Under the circumstances we have as well as an audit program, an accounting training program.

In connection with inadequate records of telephone borrowers, generally the values on the books of telephone plant in service are mis-stated; also the related depreciation reserve; and in many cases no depreciation accounting is maintained. This is due to a great extent to the fact that in the past the borrower charged replacements to maintenance and did not maintain daily time reports for classifying labor and material added and plant displaced in the outside plant. In addition, upon receipt of a supplier's invoice for material, in many cases an estimate of the portion to be charged to the plant account and to maintenance was made before the material was used. A materials and supplies account, if any, was used for only certain items.

In converting from magneto or common battery telephone systems to automatic dial systems it has been our experience in the telephone program that approximately from 80 to 100 percent of the existing telephone plant is dismantled, of which there is very little material salvaged.

In cases where telephone plant values are mis-stated on the books and no depreciation accounting has been maintained the book figure should be transferred to account 100.7, Telephone Plant Adjustment to be disposed of as the state regulatory body may direct. Any salvage realized from the dismantlement of the old plant should be credited to the amount in a/c 100.7 and debited to a/c 122 materials and supplies. If any existing telephone plant remains the appraised value should be credited to a/c 100.7 and debited to a/c 100.1, Telephone Plant in Service. The cost of removal should be charged to a/c 100.7, to be disposed of as



the state regulatory body may direct. In the states of Iowa and Texas that do not have state regulatory bodies the accounting treatment under the same circumstances should be to charge the total balance remaining in the telephone plant account to surplus or it can be amortized over a reasonable period of years through charges to surplus in accordance with the requirements of the borrower. Where a related depreciation reserve has been maintained retirements should be debited to the reserve and credited to the telephone plant account until the reserve is exhausted and the balance to be treated as previously mentioned.

When borrowers have acquired telephone properties the seller in some cases has no books or only a cash book and a subscriber ledger or may have a general ledger with a mis-stated plant value. The telephone plant values and the related depreciation reserve, if such exists, should be transferred to account 276, Telephone Plant Acquired. Telephone plants acquired by REA borrowers are generally dismantled and junked and the balance remaining in account 276, after crediting any salvage and after exhausting the depreciation reserve, is to be disposed of as the state regulatory body may direct. The difference between the purchase price of telephone plant acquired and the book value of the depreciated telephone plant should be transferred to account 100.4, Telephone Plant Acquisition Adjustment account. If the purchase price is more than the depreciated book value of the telephone plant, this will result in a debit amount in account 100.4; if less, it results in a credit amount. In either case the amounts are to be disposed of as the state regulatory body directs.

Where REA borrowers maintain adequate accounting systems in accordance with uniform systems of accounts for telephone companies prescribed by state or federal regulatory bodies, existing telephone plant accounts or telephone plant acquisitions are handled in accordance with the instructions contained therein. In cases where items are to be disposed of as the state regulatory body directs it is the responsibility of the borrower to contact the regulatory body.

The booklet entitled "Uniform Systems of Accounts Prescribed for Telephone Borrowers Financed by the Rural Electrification Administration" describes the sub-accounts designed to reflect REA loan transactions for all borrowers and membership transactions for cooperative-type borrowers of the same class. This booklet supplements the FCC Rules and Regulations, Parts 31 and 33, Uniform Systems of Accounts for Telephone Companies, and similar systems prescribed by the various state regulatory bodies. The accounts contained in the booklet are subsidiary to the basic or main accounts prescribed by the FCC or by a state regulatory body and were approved by the FCC as well as the Bureau of the Budget.

In case of an installation of supplementary accounts for a borrower operating in a state in which the regulatory body prescribes its own system of accounts for telephone companies, the subsidiary accounts installed should be changed to conform to comparable main accounts in the state system. Generally, the state systems of accounts permit telephone companies to subdivide any account, provided the subdivisions do not impair the integrity of the required accounts.

To achieve uniformity in accounting by REA telephone borrowers it will be necessary in cases such as that referred to in the preceding paragraph for the examiner to revise the account numbers, titles and texts to conform with those contained in the state system of accounts, and to prepare the preliminary draft



of revisions of pages of the REA booklet in order that a separate booklet for the state's subsidiary accounts may be issued. It is important that such revisions not conflict with any applicable rules or regulations of the state regulatory body.

The examiner who has the first audit assignment in any state where the subsidiary accounts are required to be changed to conform to the main accounts prescribed in that state will be expected to prepare a preliminary draft, as indicated above, or the necessary revisions. It will be the responsibility, therefore, of each examination manager to include instructions to this effect in assignments in connection with field audits. As soon as practicable, assignments should be made to take care of the revisions in any states where the initial audit has been completed. The revisions prepared and recommended by the examiner should be forwarded to the Office of the Controller for approval.

In carrying out their official duties, examiners must keep in mind at all times that REA does not prescribe basic accounts for telephone borrowers but that such accounts are prescribed by the various state regulatory bodies. Examiners should make sure that borrowers' personnel understand that REA is merely lending assistance in the installation and maintenance of accounts prescribed by proper authorities and is not, of itself, requiring the use of such accounts. The foregoing procedure is covered in Accounting and Auditing Staff Bulletin No. 302.

#### Subscribers' Billing

Many REA borrowers have been issuing subscribers' bills to customers monthly or quarterly in arrears. Normally procedure of the telephone industry and in accordance with good business principles is to issue subscribers bills for local service one month in advance and for toll service 40 days in arrears from the 20th of previous month plus 10 days to the first of the month. The reasons for this are: (1) the telephone company is reimbursed quicker and thus requires less working capital for the payment of tolls, payrolls, purchases of supplies, etc. (2) there are fewer subscriber disputed toll charges, as memories are better in the shorter period: (3) the accounts receivable on a monthly billing basis will be smaller than if on quarterly billing basis; therefore, collection becomes easier with a corresponding reduction in loss through uncollectible accounts. Where states permit, customers' bills, when issued, should be computed on a net rate basis instead of at gross rates from which a discount is deductible if paid on or before a specified date. Inasmuch as over 95 percent of the bills are discounted, it is more economical to bill at net rates and add the discount to the bills of the 5 percent which are delinquent than it is to deduct the discount at time of payment from each of the bills of the 95 percent paid on or before the discount date.

#### Time Reports

As the wage-hour regulations require the keeping of a time record, showing the number of hours actually worked daily by each employee, the following described forms are suggested:

1. A weekly, or monthly, time sheet or time book should be used by the employee in the general office and in the traffic department, on which each employee enters the number of hours worked each day.



2. Daily, or weekly, time and material report forms should be used by the plant department workmen to show the total number of hours each has worked per day, subdivided according to the time spent on each class of work. In cases where a company manager, or other official, spends part of his time performing plant construction or maintenance work, a time report is made out for such work the same as for other plant workmen, and the appropriate plant or maintenance account charged. The total of such charges is deducted from the amount of compensation of working executives, which otherwise would be charged to general office salaries.

#### Conversion from Cash to Accrual Basis

Many REA telephone borrowers' accounts are maintained on a cash basis in which case the examiners are instructed to convert to an accrual basis. Some borrowers close their books on June 30 or September 30. We recommend very strongly that borrowers close their books on a calendar year basis due to convenience in making annual reports to commissions, income tax returns, etc.

#### Depreciation

In regard to depreciation, it has been our experience in the telephone program that in many cases borrowers do not maintain depreciation accounting. In cases where depreciation accounting is maintained, a composite rate of 4 or 5 percent is applied to the total telephone plant in service. This rate is not based on the service life of the plant but is an estimated rate usually taken from statistics of the experience of the industry.

Administrative Bulletin T-7-R1, subject; Depreciation of Telephone Plant, states in part that the determination of depreciation rates shall be the primary responsibility of borrowers, but that the minimum composite rate for the total depreciable plant of a borrower shall not be less than 3.5 percent per annum unless a lower rate is approved by REA; provided that such minimum rate is not in conflict with applicable rules, regulations or requirements of federal or state regulatory bodies having jurisdiction over the particular borrowers in such matter.

DIVISION OF THE CONTROLLER

PANEL DISCUSSION OF QUESTIONS FROM THE FLOOR

June, 1952 Field Conferences  
Old Point Comfort, Va., and Denver, Colo.

Panel members at one or both of the conferences  
included:

Administrator Wickard	Virgil P. Russell
John C. Cooper, Jr.	Keith H. Kittle
E. T. Nolan	Elton L. Bennett
T. A. Hoffman	Howard C. Paine
Harold J. Selinsky	W. Bernard Loving
Henry Freedman	Albert B. O'Donnell
Leslie Surginer	Rolland W. Mars
Kenneth L. Smith	Eugene R. Riddle
Robert A. Stein	Richard Platte
Wells E. Ludlow	



- Q. In the new organization, are examiners to explain to bookkeepers the accounts to be used for specific items?
- A. You should continue giving correct explanations of proper classification but avoid, to the greatest extent possible, the necessity for changing what has been done by auditors in the past. Adjustment of prior auditors' entries may be made only upon the approval of the examination managers.
- 

- Q. What should be done about answering letters requesting information?
- A. Acknowledge letter and advise inquirer that letter has been forwarded to the general field representative or the area office for reply. Telephone requests for information should be given the best possible answer and the inquirer advised to communicate with the area office or its general field representative in the future.
- 

- Q. Will the examiner continue to send a letter of recommendation to the borrower following the audit?
- A. The examiner is still to discuss the audit report with the manager and office personnel but he is not to write a letter of recommendations under the same circumstances as in the past. If the examiner can make a determination at the start of the audit as to the relative significance of the accounting advice necessary during his assignment, he should, when necessary, consult with his supervisor and, if possible, obtain through the line organization authorization to conduct an accounting advice and assistance assignment in conjunction with his audit, and thus be in a position to furnish the required written accounting recommendations to the borrower and the line organization. Otherwise, the accounting recommendations resulting from an audit should be submitted with the audit report for forwarding to the Washington office of the line organization concerned, for ultimate transmittal to the borrower with the report.
- 

- Q. Should the examination supervisor be present when the audit is reviewed with the manager or office personnel?
- A. Not necessarily. The examiner is to exercise judgment and there may be cases wherein he will want to ask the supervisor to be present, if possible.
- 

- Q. Is the examiner not to make major audit adjustments and not to make sure that even any minor audit adjustments are recorded on the books?
- A. That was the thinking in REA for awhile, but the decision has now been made that the examiners are to operate as in the past in this regard -- that is, suggest such audit adjustments as they find necessary to correct and improve the records and, insofar as possible, determine that the adjusting entries are recorded on the borrower's books.
-

Q. If major account advice and assistance may not be given without a request from the line organization, what is to be done about bookkeepers' routine questions during the course of audits?

A. Be reasonable in such matters and give the best available answers, when no substantial change will be effected in the borrower's procedures. There should be no hesitancy in answering questions covered in existing REA recommendations.

-----

Q. Are work papers to be made available for copying by borrower's personnel as in the past?

A. Yes.

-----

Q. Will follow-up on audits now be done by line organizations?

A. Yes, that is their responsibility under the new organization.

-----

Q. Who will notify borrowers of forthcoming audits?

A. The line organization will do this on the basis of letters prepared in the Controller's Division for signing by the line organization chief or director.

-----

Q. Will accounting advice and assistance be given by any REA representatives other than members of the Controller's Division?

A. Yes. Each of the line organizations will have accountants who will prepare letters on accounting matters for dispatch to borrowers by the line office. Our technical staff will be called upon to help prepare such letters, as necessary, and we are to be furnished with copies of all such letters.

-----

Q. If the examiner has planned to audit a borrower's books as of the end of a particular month, but the trial balance cannot be taken until the 15th of the following month, should the examiner wait for it or move the date of his audit back a month?

A. He should not hold up the audit but should make it as of the end of the most recent period for which the books have been closed.

-----



- Q. Should the examiner see to it that an adjusting operating report is submitted by the borrower at the conclusion of his audit?
- A. It is the responsibility of the examiner to call attention to the need for an adjusting operating report and to assist and urge the borrower's personnel to prepare such operating report.

----

- Q. Should the examiner assist the bookkeeper, if requested, in preparing an insurance register or developing other types of subsidiary records?
- A. Not without an official assignment to perform accounting advice and assistance as distinct from making an audit.

----

- Q. Should the bookkeeper be asked to make copies of those audit schedules which the examiner feels should be of value in maintaining the records?
- A. The examiner should make them available, with an explanation as to the value they would have for the bookkeeper, but, of course, he should not insist on their being copied if the bookkeeper does not voluntarily choose to copy them.

----

- Q. Should the examiner send the audit report to the line organization or to the examination manager?
- A. Neither one. It should be forwarded by the examiner to the examination supervisor in the field, who will review it and send it on to the examination manager in Washington.

----

- Q. Will REA continue to exercise responsibility for approval of borrowers' managers?
- A. Yes. Even though borrowers will have increasing responsibility, REA is still vitally interested in obtaining the best possible management for the systems.

----

- Q. Will a bulletin be issued explaining to a greater degree the handling of interest savings and cushion of credit payments under the revised REA billing procedure?
- A. Such a bulletin has been issued by the Administrator to REA Electrification Borrowers under the date of July 30, 1952, referring to the subject, "Accounting for Interest Savings Associated with 'Cushion of Credit.'"

----

Q. Can arrangements be continued under the reorganization whereby engineers and examiners may work together in closing out inventories?

A. Most assuredly. It will merely require co-ordination by supervisors.

-----

Q. Who will release REA bulletins:

A. REA policy statements, bulletins to borrowers and important staff instructions will be signed by the Administrator.

-----

Q. Audit reports on Nebraska public power districts must include a schedule of work in progress. Can this be extended to all audit reports?

A. The desirability of showing a summary of changes in utility plant in the current period, including changes in work in progress, is recognized in the new REA bulletin, "Suggested Minimum Audit Standards for Certified Public Accountants Examining the Books of REA Borrowers (Electric)". Examiners may follow the example presented therein.

-----

Q. What is the examiner to do about verification of REA borrowers' old accounts receivable when such old accounts are disconnected?

A. The examiner need not spend a lot of time attempting to confirm dead accounts but should look into the approval of the disconnections, write-offs, etc. He should learn whether the cooperative has a history file on such consumers to make sure that they pay if they come back on the lines. He needs to appraise internal control and make sure that such accounts are not used as a means of perpetrating frauds.

-----

Q. May the tracing of subsequent cash collections be substituted for confirmation of accounts receivable?

A. Yes, if the examiner can assure himself as to cash control and the source of the cash in question.

-----

Q. To whom are examiners' reports addressed and presented when the examiners work on advice and assistance assignments?

A. Such reports are to be addressed to the area director or line division chief, as the case may be, and are to be presented or mailed to that individual unless instructions in the specific assignment direct otherwise. In all cases, a copy of the report is to be sent to the examination supervisor, who is subsequently to forward it to the examination manager.

-----



Q. Will the existing procedure pertaining to examiners' attending board of directors' meetings be changed?

A. Examiners will continue to meet with boards of directors regarding audits only upon authorization through the examination manager. If on assignment to line organizations, they will carry out the wishes of the line organizations in the matter.

----

Q. What will be done about examiners' attendance at joint REA-TVA meetings?

A. Such attendance ordinarily will be co-ordinated by the area office.

----

Q. Will the line division representative desiring an examiner's assistance remain with the examiner during the assignment?

A. That will depend on the line organization's representative and the nature of the assignment.

----

Q. May a line organization representative call up an examiner and ask him to come over to another borrower's office for a short discussion?

A. No. An examiner is not to travel officially without assignment through his own organization. He may, however, fulfill a request by a line organization's representative for special assistance up to one full day's time, at the borrower's office where the examiner is already located, without advance assignment from his own supervisor. He must then prepare an assignment schedule for the work done and send it to his supervisor for execution and return to him.

In general, field requests for accounting advice and assistance are to be made by the line organization representative directly to the examination supervisor. The latter is to make such assignment as he sees fit in fulfilling these requests, up to a total of three working days for any one assignment, and he is promptly to submit a copy of the assignment schedule to the examination manager. Requests involving work of more than three days duration must be taken up with the examination manager. In the event the request clears through or originates with the Washington office of the line organization, the examination manager may make direct assignments to examiners, with immediate notification being given to the examination supervisor concerned. However, it is generally expected that, where circumstances permit, such assignments will be made through the examination supervisor.

----

Q. Do the field regulations just discussed apply equally to the telephone and electrification programs?

A. Yes.

Q. May examiners or examination supervisors visit regulatory bodies or their staffs?

A. Not without the approval of the Administrator.

----

Q. May the Controller's Division field people write to regulatory bodies for copies of systems of accounts or other manuals?

A. Yes, they may. However, if there is any charge for such manuals, reimbursement is not to be requested on travel vouchers.

----

Q. Will supplementary accounts, particularly in the telephone program, have to be cleared with state regulatory bodies?

A. Such accounts are ordinarily subaccounts to the main system and are thus permitted to be added to the systems prescribed by most regulatory bodies, as stated in their publications, as long as this action does not affect the integrity of the main accounts.

----

Q. Should differences between accounts of telephone borrowers and those recommended by REA be set forth in examiners' reports?

A. If borrowers have established accounts differing from those prescribed by the FCC or the state regulatory body, the examiner should make a full report on the matter, since such deviations are contrary to REA recommendations.

----

Q. What provision will be made for giving accounting training to accountants of telephone borrowers?

A. The Telephone Loans Division will provide accounting assistance through its staff in the Washington office. Upon request by that division, field examiners of the Controller's Division will give field advice in accounting and help train borrowers' accounting personnel. Moreover, it is contemplated that the REA Correspondence Accounting Course will be expanded to cover telephone accounting.

----

Q. In making an internal audit, is the examiner to observe the degree of compliance with all policies and procedures, even those dealing with technical matters outside his field of specialization?

A. Good judgment will be required. It is expected that progress will be shown in developing complete internal audit techniques. However, it is basic that the examiner is to avoid technical comment on unfamiliar subjects.

----



Q. Will the examiner's observations be furnished to borrowers?

A. The examiner's observations and comments resulting from his financial audit of the borrower's records will be included in the general comments of the audit report (except for those of such nature as to warrant inclusion only in the confidential ADM-36 report) and will, of course, be furnished to the borrower. However, the examiner's internal audit is made with reference to REA procedures and relationships and will be furnished only to REA.

----

Q. Should not the examiner, in making an internal audit of REA activities, be furnished with a check list to aid him in determining the compliance with and effectiveness of REA's plans, policies, and procedures.

A. Yes, he certainly should. Such a list will be included in the internal audit procedure which is to be developed by the Controller's Division.

----

Q. Are examiners to put in their field activities reports comments about the reaction of borrowers to the reorganization of REA?

A. Yes.

----

Q. What should examiners do about adverse comments about other REA people?

A. Listen carefully to determine whether there appears to be anything substantial enough for application of internal audit principles, but avoid comment.

----

Q. Are examiners to report good points as well as deficiencies?

A. Yes, by all means.

----

Q. Should not examiners be informed as to instructions given by other REA divisions or field personnel?

A. Yes. Correspondence relative to accounting is to be made available to examiners.

----

Q. What about reporting the activity of labor unions?

A. In general, avoid comment on this subject.

----

- Q. What about reporting articles in the press detrimental to REA?
- A. Include information thereon in your field reports to Washington.

----

- Q. Are field examiners to make reports to Washington with reference to actions of other REA employees?
- A. As examiners, you have the same responsibility as every other conscientious REA employee to report those things which tend to discredit REA operations -- you do not have a special commission to do more in this respect than members of other divisions.

In arriving at an answer to this question, you are referred to the record of the Administrator's talk at the conferences concerning the manner in which the field examiners are to carry out their duties, including the making of reports on activities of other REA employees. The examiner must exercise good judgment. In general, he must be very discreet in making any inquiries prompted by an initial observation of possible misconduct. Unless he has been given a definite assignment to investigate a fellow employee, the examiner must feel assured in his own mind that any reporting he chooses to do with regard to other REA employees is absolutely justified on the basis of information which has come to him and which he has quietly verified to the extent possible. Remember you are not "the Administrator's bird dog looking after everything and everybody." You should strive "to attain that balance which avoids snooping yet does not call for you to be blind."

----

- Q. What if a CPA firm asks an examiner whether a particular borrower is to be on the list for audit by CPA's?
- A. The reply should be that such information may not be given out until the REA list of borrowers subject to CPA audit is released.

----

- Q. If a cooperative which has qualified for CPA audit falls behind in its debt service and feels that it cannot afford to pay for audits, will it be permitted to revert to having its audits made by REA?
- A. The status of all borrowers will be reviewed by the Controller's Division, the Executive Officer, and the office of the line organization to determine whether, under existing policy, the borrower will be required to have CPA audits. Generally, we do not expect that once a borrower has met the qualifications for independent audit it will revert to the older plan. However, such a possibility is not precluded, and each case will be referred to the Administrator, with committee recommendations, for final decision.

----



Q. What is REA's reaction to the proposal for setting up by statewide organizations of auditing units staffed by CPA's?

A. REA has not looked with favor on state associations' furnishing auditing service, because such procedure would not meet the requirement of independence in auditing. REA wants to be able to say that an auditor engaged by a borrower is not being held directly or indirectly responsible to the state association, but is entirely independent.

Moreover, in some states, there might be a question as to how an accountant working with a state association could certify independently to the financial condition of any member of such association. REA would probably not object to a statewide association's assisting borrowers in maintaining proper accounts, but it would object to that association's furnishing the audit service.

-----

Q. How could REA's objection to auditing service through state associations be made effective?

A. REA could cite the provisions of the mortgage or indenture requiring auditing service satisfactory to this agency. No general answer can be given as to what action would be taken if a borrower continued to disregard its REA contract; however, the courts might enforce adherence to those provisions of the contract.

-----

Q. Will it not be necessary to use more tact in dealing with telephone borrowers than with electric borrowers, even though it is very important in all cases?

A. Yes. This is especially necessary because the telephone industry has expressed itself as wary of the government's intentions in the telephone field.

-----

Q. Must leave earned in 1952 be used prior to June 30, 1953?

A. Yes.

-----

Q. Leave taken after December 20, 1952, is charged to what year?

A. 1953

-----

Q. If a traveler must leave his temporary duty station before the end of the work day in order to get home to headquarters for the week-end, must he take leave?

- A. Yes. No official time may be used for travel to and from headquarters merely for the convenience of the traveler.

----

- Q. If the examiner completes an assignment on Friday evening at a temporary duty point and travels home to headquarters for the weekend, is such travel considered official?
- A. Only if it were officially necessary to return to headquarters, or if such return resulted in a saving to the government with respect to subsistence and mileage.

----

- Q. If an examiner works on official duties on Monday night, may he take compensatory leave on Tuesday?
- A. No compensatory leave may be taken unless the overtime work is authorized in advance.

-----



1. The first of these is the fact that the number of cases of disease is increasing.

2. The second is the fact that the number of cases of disease is increasing.

3. The third is the fact that the number of cases of disease is increasing.

4. The fourth is the fact that the number of cases of disease is increasing.